85-869

No. 85-

Supreme Court, U.S.
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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1985

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LUBRIZOL ENTERPRISES, INC.,
*Petitioner,*

v.

ROBERT A. CANFIELD, BANKRUPTCY TRUSTEE FOR RICHMOND METAL FINISHERS, INC.,
*Respondent.*

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## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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## QUESTION PRESENTED

Whether Section 365(g) of the Bankruptcy Code, which authorizes the Trustee to reject an executory contract and provides that rejection of the contract shall be a "breach" of the contract, authorizes the bankruptcy court to order rescission of the contract divesting the non-debtor party of property it has acquired under the contract prior to the bankruptcy filing.

## STATEMENT PURSUANT TO RULE 28.1

Petitioner Lubrizol Enterprises, Inc. has the following parent companies, subsidiaries (except wholly-owned subsidiaries) and affiliates:

The Lubrizol Corporation, Lubrizol Transarabian Company, Ltd., Lubrizol India Ltd., I.A.B.—Industria de Aditivos do Brasil S.A., Industrias Lubrizol S.A. de C.V., C.A. Lubricantes Quimicos L.Q., Altus Corporation, Chem-Design Corporation, Creative BioMolecules, Inc., Genentech, Inc., Greenwich Oil Corp., Sungene Technologies Corporation, Zikonix Corporation, Elpower Corporation, Catalytica Associates (Limited Partnership), Specialty Chem Products Corporation, Agrigenetics Research Corporation, Agrigenetics Research Associates Ltd. (Limited Partnership), GLC Associates (Limited Partnership), Intera Company, Ltd. (Limited Partnership), Syntro Corporation, Mycogen Corporation.

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v.

ROBERT A. CANFIELD, BANKRUPTCY TRUSTEE FOR RICHMOND METAL FINISHERS, INC.,
*Respondent.*

---

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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Petitioner respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit in this case.

## OPINIONS BELOW

The opinion of the Court of Appeals (App. 1a) is reported at 756 F.2d 1043 (4th Cir. 1985). Its order denying rehearing and rehearing *en banc* (App. 41a) is not officially reported.

The opinion of the District Court (App. 12a) is reported at 38 Bankr. 341 (E.D. Va. 1984).

The opinion of the Bankruptcy Court (App. 28a) is reported at 34 Bankr. 521 (Bankr. E.D. Va. 1983); its order denying a stay pending appeal (App. 20a) is reported at 36 Bankr. 270 (Bankr. E.D. Va. 1984).

## JURISDICTION

The judgment of the Court of Appeals was entered on March 15, 1985 (App. 40a). A timely petition for rehearing and rehearing *en banc* was denied on August 22, 1985 (App. 41a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

## STATUTES INVOLVED

Bankruptcy Reform Act of 1978, §§ 365 and 502(g), 11 U.S.C. §§ 365 and 502(g) (1982) are set out in the appendix (App. 43a).[1]

## STATEMENT

Petitioner Lubrizol Enterprises, Inc. ("Lubrizol") and Richmond Metal Finishers, Inc. ("RMF")[2] entered into a Technology License Agreement dated July 8, 1982 (the "Agreement"; App. 51a) covering proprietary technology made or developed by RMF for providing metallic articles with wear-resistant coatings. RMF immediately disclosed to Lubrizol, by delivering certain manuals and other documents (App. 30a, 33a; 34 Bankr. at 523, 524), all technology made or developed up to April 1, 1982 (the "Technology"), including that covered by any patents thereafter issued (none were). That transfer did not in-

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[1] Subsequent to the decision of the Bankruptcy Court in this case, § 365 was amended in several respects not relevant to this petition.

[2] Respondent Robert A. Canfield is the Bankruptcy Trustee for RMF. Subsequent to the decision below, this case, which had been proceeding under Chapter 11 of the Bankruptcy Code, was converted to one under Chapter 7 and Robert A. Canfield was appointed trustee. The parties in the court below were Lubrizol and RMF.

clude any technology made or developed after that time (App. 53a). In return Lubrizol cancelled certain loans which it had made to RMF for the development of the Technology (App. 52a).

Although Lubrizol was not to make use of the Technology until after May 1, 1983 (App. 2a; 756 F.2d at 1045), and until that date RMF was authorized to seek a purchaser for Lubrizol's rights under the Agreement (App. 58a-59a) (none was found), Lubrizol was free thereafter to use the Technology permanently. Lubrizol was obliged to keep the Technology confidential for 17 years beginning on April 1, 1982 (App. 55a). During the same 17-year period, from the time of Lubrizol's first commercial sale (which has not yet occurred), Lubrizol was to pay to RMF a series of deferred cash payments of 5% of Lubrizol's net sales price of any product embodying the Technology (App. 56a-57a). Thereafter, there was no further charge for Lubrizol's use of the Technology. Lubrizol's right to use, make, and sell products embodying the Technology was not exclusive (App. 2a; 756 F.2d at 1045), but if RMF authorized anyone else to make, use, or sell products embodying the Technology on terms more favorable to the party receiving disclosure of the trade secret information, Lubrizol's payments during the 17-year period would be automatically reduced to those more favorable terms (App. 62a). Continuing obligations linked the parties.[3]

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[3] The court below succinctly summarized those obligations (App. 2a; 756 F.2d at 1045): "RMF owed the following duties to Lubrizol under the agreement: (1) to notify Lubrizol of any patent infringement suit and to defend in such suit; (2) to notify Lubrizol of any other use or licensing of the process, and to reduce royalty payments if a lower royalty rate agreement was reached with another licensee; and (3) to indemnify Lubrizol for losses arising out of any misrepresentation or breach of warranty by RMF. Lubrizol owed RMF reciprocal duties of accounting for and paying royalties for use of the process and of cancelling certain existing indebtedness." In addition, Lubrizol was obligated to maintain

On July 1, 1983, RMF filed a petition under Chapter 11 of the Bankruptcy Reform Act of 1978 (the "Code").[4] Neither party was in default under the Agreement on that date (App. 13a; 38 Bankr. at 342). On August 16, 1983, RMF moved for authorization from the Bankruptcy Court to reject the Agreement under § 365(a) of the Code, 11 U.S.C. § 365(a). At the hearing on the motion, RMF's president testified that RMF sought rejection of the Agreement in order to try to sell the exclusive right to the Technology to a third party (App. 13a; 38 Bankr. at 342). Significantly, RMF did not rely on the burden to its estate of its future obligations under the Agreement.

The Bankruptcy Court relied on the future obligations existing on both sides of the Agreement, and on this basis found that it was "executory". Over Lubrizol's objection, RMF's motion was granted (App. 38a; 34 Bankr. at 526).

Lubrizol appealed to the District Court, which found that RMF's stated reason for rejecting the Agreement was based on a misperception of the law. The District Court held that RMF could not use § 365 to deprive Lubrizol of Technology that had already been transferred to Lubrizol before RMF's bankruptcy filing. All that RMF could accomplish was to relieve itself of its future obligation "to defend Lubrizol's title," an obligation which was "not onerous at the present time" (App. 18a; 38 Bankr. at 344). Because RMF's only basis for rejecting the Agreement was an erroneous reading of the law, and, alternatively, because rejection would not benefit the estate, the District Court reversed the decision of the Bankruptcy Court (App. 19a; 38 Bankr. at 345).

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the confidentiality of the Technology for a period of seventeen years.

[4] The jurisdiction of the Bankruptcy Court was invoked under 28 U.S.C. § 1471.

In its appeal to the court below, RMF again maintained that rejection of the Agreement under § 365 would deprive Lubrizol of any rights in the Technology. The court below, observing erroneously that under § 365(g) a claim for monetary damages against the debtor is the sole remedy available to a contracting party such as Lubrizol, held that to allow Lubrizol to use the Technology disclosed to it prior to RMF's bankruptcy filing would amount to "specific performance" of the Agreement. On this basis, although it took note of the strong countervailing policy considerations, including "obvious adverse consequences" to those who deal with "potential bankrupts" (App. 9a-10a; 756 F.2d at 1048), it reversed the District Court. A timely petition for rehearing and suggestion of rehearing *en banc* was denied by the court below in a 6-5 vote on August 22, 1985 (App. 41a).

On September 23, 1985 the Bankruptcy Court entered an order converting the bankruptcy proceeding to Chapter 7 of the Code and appointed Respondent Robert A. Canfield to be trustee of the estate of RMF.

## REASONS FOR GRANTING THE WRIT

### I. The Decision Below Jeopardizes the Stability of All Property Transfers Made Pursuant to Contracts Which Contain Covenants Surviving the Closing.

Until the decision below, no court had held that a bankruptcy trustee or debtor-in-possession (collectively, "DIP") can, under the guise of relieving the bankruptcy estate of future performance obligations, deprive the other party to a contract, who is not in default, of the benefit of the debtor's contractual performance already made *prior* to the bankruptcy filing. The court below held that a DIP has the power, not only to relieve the bankruptcy estate of future performance obligations, but also to effect a complete rescission of a technology trans-

fer.[5] Indeed, the court below did not in any way limit its opinion to technology transfers. The DIP, under the decision below, can strip the other contracting party of all personal property which had been transferred long before the bankruptcy filing under any contract which includes covenants that continue at the time of the bankruptcy filing.

This holding undermines the common and reasonable assumption of contracting parties that once performance under a particular phase of a contract is complete, that performance cannot be undone simply because of one party's "business judgment" that rescission would benefit it.[6] The Fourth Circuit has held in this case that, by seeking relief under Chapter 11 of the Code, a DIP can avoid not only those few narrow types of transfers which the Code plainly states are subject to avoidance—preferential transfers (§ 547), fraudulent conveyances (§ 548), and other transfers covered by §§ 544, 545, 549, 553(b) and 724(a)—but also completed transfers involving some remaining additional performance, no matter how incidental or contingent. Section 550, authorizing the recovery of property where transfers are avoided, refers to those transfers avoided under all of the sections cited above, but makes no reference to § 365. Property recovered under § 550 becomes property of

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[5] The court below said in its opinion that it disagreed with the conclusion of the District Court that there was "effectively a completed sale of property" (App. 5a; 756 F.2d at 1046), and said that the transaction was more like a lease. But it could not be a lease, since the property—delivered pursuant to the contract, as was undisputed in the Bankruptcy Court (App. 30a; 34 Bankr. at 523)—remains with the transferee at the end of the contract term (Agreement, Article III, App. 55a and Article XIII(6), App. 63a). Under all relevant law, such transactions are sales. U.C.C. § 1-201(37) (1977); S. Rep. No. 989, 95th Cong., 2d Sess. 64, *reprinted in* 1978 U.S. Code Cong. & Ad. News 5787, 5850 (report on Bankruptcy Reform Act of 1978).

[6] The District Court recognized this. App. 18a n.3; 38 Bankr. at 345 n.3.

the estate under § 541(a)(3), but there is no reference in § 541 to property recovered under § 365.

The court below made no attempt to narrow the scope of its novel power of rescission, which seemingly would extend to transfers completed many years before any bankruptcy. Instead, it simply noted that "general hazards [are] created by § 365 for all business entities dealing with potential bankrupts" (App. 10a; 756 F.2d at 1048).

Contracts providing for disclosure of confidential technological information have become a standard means of financing technological development in the United States. Much of the technology on which American businesses depend for their day-to-day operations is the proprietary information of the developer, who has marketed it to other users through non-exclusive trade secret or other technology transfer agreements. Such transfers include not only industrial improvements such as the metal treating process involved in this case, but also span a broad spectrum of newer ventures including computer software and hardware, electronics, genetic engineering, pharmaceuticals, robotics, and the other so-called "high-tech" industries. *See* Mirabito, *Technology Transfers of Patent/Data Rights in the Commercial Sector: A Primer*, 7 B.C. Int. Comp. L. Rev. 251, 254 (1984).

Franchise agreements, distributorship arrangements and dealership agreements likewise frequently involve initial disclosure of valuable confidential information followed by ongoing obligations for the development and exploitation of that information. Effective exploitation and development of such disclosures require that both those who first conceive new ideas and those who make possible the commercial development of such ideas be able to transfer information and know-how about the ideas of executing and carrying out legally binding agreements that are not rendered illusory by an eventual bankruptcy filing.

The continuing covenants in the Agreement here are no different from covenants that are common in all types of commercial relations. The fact that parties have continuing obligations toward one another after transferring significant property is not an appropriate basis for exposing the parties to rescission of the portions of their agreement which are already complete. Brief consideration of the possible applications of the decision below reveals the major problem it presents for arrangements on which the American law and economy depend. For example, if one sells his business, his agreement not to compete in a reasonable geographic area and for a reasonable length of time clearly should not expose the purchaser to the risk of rescission of the transfer of the business assets if the seller should file for bankruptcy during the term of the non-competition covenant.

In entering this arrangement, Lubrizol recognized that the bankruptcy of RMF might prevent future performance by RMF of post-bankruptcy obligations under the Agreement. But the decision below creates a much larger risk. Under that decision, Lubrizol lost not only the benefit of RMF's covenants for future performance, but the benefit of all of RMF's performance completed before the petition was filed.

The Fourth Circuit misread § 365(g) since that section, far from authorizing rescission of a contract, provides only that the rejection of a contract shall be a breach of the contract. It is § 502(g), not § 365(g) as cited by the court below, which provides that a claim "arising from the rejection under § 365 . . . shall be allowed . . . as if such claim had arisen before the date of the filing of the petition." There is nothing in that section, nor elsewhere in the Code, nor in general contract law, which authorizes the court under the circumstances of this case to require retransfer of property. The unprecedented reasoning of the court below could

be applied to virtually every ongoing contractual relationship of bankruptcy debtors and "potential bankrupts."

### II. Uncertainty Will Inevitably Result Unless This Court Grants Review.

In the absence of prompt correction, the decision below could precipitate a multiplicity of Chapter 11 proceedings because "potential bankrupts" will believe themselves entitled to a right to rescind which they obviously would not have outside of a bankruptcy proceeding. This Court should review that decision now to avoid the confusion and litigation that the decision inevitably creates. *See American Federation of Musicians v. Wittstein*, 379 U.S. 171, 175 (1964). *See also Sony Corp. v. Universal City Studios*, 464 U.S. 417 (1984).

The decision below makes rescission available to a DIP, notwithstanding the absence of any conduct on the part of the other party usually required to give rise to such a drastic remedy. The issue is sharply presented in this case, so that a decision by this Court can clearly and effectively settle the question presented for review. No subsidiary matters need stand in the way of answering this single crucial question as to the meaning of rejection under § 365.[7]

The developing conflict on the issue presented here goes beyond the differing opinions among judges in the Fourth Circuit. Bankruptcy proceedings arise, of course, in every circuit. The question of the effect of rejection of

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[7] This petition does not present the question of the meaning of the term "executory contract" as used in the Bankruptcy Code. That question, recently addressed in another context by this Court in *N.L.R.B. v. Bildisco & Bildisco*, 104 S. Ct. 1188, 1194 n.6 (1984), is a difficult one which turns on the facts of an individual case. The question presented to this Court is not whether the Agreement is executory, but rather what are the consequences which flow from a finding that it is.

the performed part of a partially performed contract is one which can be expected to arise in all circuits. This Court has considered the multiplicity of possible decisions on a question of statutory construction as contributing to the issuance of certiorari. *See Laing v. United States*, 423 U.S. 161, 167 (1976).

### III. The Decision Below Is So Plainly Incorrect as to Require Correction by This Court.

This is the first reported judicial decision in American legal history to hold that a DIP can, by rejecting an executory contract, take away from the other party to a contract, who is not in default, the benefit of the debtor's performance rendered prior to the filing of bankruptcy. This amounts to an injunction against Lubrizol's using intellectual property already transferred to it. There is nothing in § 365(g) or elsewhere in the Code which authorizes such a remedy.

When Lubrizol objected to being "stripped" of the property it had already received, it was not, contrary to the analysis in the opinion below, seeking "specific performance" of the Agreement. The July 8, 1982, transaction between Lubrizol and RMF involved three separate components: (1) a transfer of the Technology from RMF to Lubrizol which was performed by RMF immediately on execution of the Technology License Agreement, (2) cancellation of certain indebtedness of RMF to Lubrizol and (3) the undertaking of certain continuing obligations by both Lubrizol and RMF. Lubrizol is here objecting to the undoing of the first of these components; it is not seeking specific performance of the third component, the only one of the three not fully completed.

The purpose of empowering a DIP to reject executory contracts is to allow the comparison of (1) the cost to the estate of performing the DIP's unperformed obligations and the value to the estate of receiving the non-debtor's future performance with (2) the effect of damage claims

against the estate resulting from rejection. Only then can the DIP determine whether the rejection will benefit the estate. The power to reject has never heretofore been thought to include the power to rescind the debtor's prepetition performance. To the contrary, both the language of § 365(g), stating that rejection constitutes a "breach" of the contract, and case law, observing that the concept of rescission has no place in the rejection of executory contracts, negate any power to rescind. *Murphy v. C & W Limited Corp. (In re Murphy)*, 694 F.2d 172, 174 (8th Cir. 1982) (decided under former Bankruptcy Act):

> We agree that rejection of an executory contract in accordance with applicable provisions of the Bankruptcy Act is not the equivalent of rescission. *Consolidated Oil & Gas, Inc. v. Sun Oil Co. of Pennsylvania*, 16 B.R. 490, 493 (D.C., D.Co. 1981). Rather, as stated, rejection constitutes a breach of contract, and a person injured thereby is deemed a creditor and is entitled to assert a claim for damages.

The proper operation of the power to reject executory contracts is illustrated by *Fenix Cattle Co. v. Silver (In re Select-A-Seat Corp.)*, 625 F.2d 290 (9th Cir. 1980). There the debtor, prior to bankruptcy, had by agreement given Fenix an exclusive license in certain areas of the world to use and license the debtor's computer software package for remote outlet sales of tickets. Under the agreement, Fenix paid a flat fee and 5% of its annual net income from the license. The debtor also "transferred the software packages with service manuals to Fenix" (625 F.2d at 291). It was held that the debtor's Chapter X trustee could, with approval of the Bankruptcy Court, reject the licensing agreement with Fenix, which was executory because of the continuing obligation of Fenix to pay royalties and the continuing obligation of the debtor, because the license was exclusive, "not to sell software packages to other parties" (625 F.2d at 292).

Fenix had contended, as RMF is contending here, that rejection of the contract amounted to a rescission, setting

aside the transfer of software, and that approval of the rejection was not within the summary jurisdiction of the Bankruptcy Court under the old Bankruptcy Act (625 F.2d at 292). The Ninth Circuit held that this contention was based on a mischaracterization of what the trustee sought to accomplish by rejection:

> The trustee did not seek to recover the tangible property transferred to Fenix, the software packages and accompanying service manuals. Nor did the trustee attempt to revoke Fenix's license; Fenix may still use and sell the computer materials it received from Select-A-Seat. The trustee merely sought to reject the executory portions of the contract, the continuing warranty and exclusive dealing obligations. . . . [T]he license . . . cannot be summarily terminated, but rejection can cancel covenants requiring future performances by the debtor. . . . If Fenix has been injured by the rejection of the executory portions of the licensing agreement, it may file a claim for its damages as a creditor of the estate.

625 F.2d at 292-93.

The exclusivity of the licensing agreement in *Select-A-Seat* imposed an additional continuing obligation on the licensor-debtor—it could not grant competing licenses to others. That obligation, of course, did not negate the fact that a completed transfer of technology to the licensee had taken place. Such a transfer occurs whether the license is exclusive or non-exclusive. Nor was the licensee's continuing obligation to make royalty payments in *Select-A-Seat* (or in this case) inconsistent with the existence of a completed transfer. As this Court recognized in a non-bankruptcy context, in *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257 (1979), a continuing obligation to make royalty payments was in no way inconsistent with an earlier completed transfer by the licensor of a key-holder design which the licensor had "disclosed . . . in confidence" to the licensee. 440 U.S. at 263.

Once technical knowledge has been disclosed and transferred, general principles of contract and property law do not permit its recapture. There is nothing in the Bankruptcy Code that requires or allows a different result in bankruptcy.

## CONCLUSION

This case presents an issue of substantial importance in the business world. The issue is directly and clearly presented. In the absence of review by this Court, the decision below will lead to continuous litigation and confusion in the lower courts. The sound and efficient administration of the Bankruptcy Code will be greatly facilitated if this Court provides a definitive answer to the question at this time.

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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November, 1985

# APPENDIX

## APPENDIX

## UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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No. 84-1539

---

LUBRIZOL ENTERPRISES, INC.,
*Appellee,*

versus

RICHMOND METAL FINISHERS, INC.,
*Appellant.*

IN RE: RICHMOND METAL FINISHERS, INC.,
*Debtor.*

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Appeal from the United States District Court
for the Eastern District of Virginia, at Richmond.
D. Dortch Warriner, District Judge.
(C/A 84-0074-R)

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Argued December 3, 1984 Decided March 15, 1985

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Before PHILLIPS and WILKINSON, Circuit Judges, and BUTZNER, Senior Circuit Judge.

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James R. Sheeran for Appellant; Marilyn Shea-Stonum (Jeanne M. Rickett; Jones, Day, Reavis & Pogue; Benjamin C. Ackerly; Dennis T. Lewandowski; Hunton & Williams on brief) for Appellee.

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PHILLIPS, Circuit Judge:

The question is whether Richmond Metal Finishers (RMF), a bankrupt debtor in possession, should have been allowed to reject as executory a technology licensing agreement with Lubrizol Enterprises (Lubrizol) as licensee. The bankruptcy court approved rejection pursuant to 11 U.S.C. § 365(a); but the district court reversed on the basis that within contemplation of § 365(a), the contract was not executory and, alternatively, that rejection could not reasonably be expected substantially to benefit the bankrupt debtor. We reverse and remand for entry of judgment in conformity with that entered by the bankruptcy court.

I

In July of 1982, RMF entered into the contract with Lubrizol that granted Lubrizol a nonexclusive license to utilize a metal coating process technology owned by RMF. RMF owed the following duties to Lubrizol under the agreement: (1) to notify Lubrizol of any patent infringement suit and to defend in such suit; (2) to notify Lubrizol of any other use or licensing of the process, and to reduce royalty payments if a lower royalty rate agreement was reached with another licensee; and (3) to indemnify Lubrizol for losses arising out of any misrepresentation or breach of warranty by RMF. Lubrizol owed RMF reciprocal duties of accounting for and paying royalties for use of the process and of cancelling certain existing indebtedness. The contract provided that Lubrizol would defer use of the process until May 1, 1983, and in fact, Lubrizol has never used the RMF technology.

RMF filed a petition for bankruptcy pursuant to Chapter 11 of the Bankruptcy Code on August 16, 1983. As part of its plan to emerge from bankruptcy, RMF sought, pursuant to § 365(a), to reject the contract with Lubrizol in order to facilitate sale or licensing of the technology unhindered by restrictive provisions in the Lubrizol

agreement. On RMF's motion for approval of the rejection, the bankruptcy court properly interpreted § 365 as requiring it to undertake a two-step inquiry to determine the propriety of rejection: first, whether the contract is executory; next, if so, whether its rejection would be advantageous to the bankrupt.

Making that inquiry, the bankruptcy court determined that both tests were satisfied and approved the rejection. But, as indicated, the district court then reversed that determination on the basis that neither test was satisfied and disallowed the rejection. This appeal followed.

## II

We conclude initially that, as the bankruptcy court ruled, the technology licensing agreement in this case was an executory contract, within contemplation of 11 U.S.C. § 365(a). Under that provision a contract is executory if performance is due to some extent on both sides. *NLRB v. Bildisco and Bildisco*, —— U.S. ——, ——, 104 S. Ct. 1188, 1194 n.6 (1984). This court has recently adopted Professor Countryman's more specific test for determining whether a contract is "executory" in the required sense. By that test, a contract is executory if the " 'obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete the performance would constitute a material breach excusing the performance of the other.' " *Gloria Manufacturing Corp. v. International Ladies' Garment Workers' Union*, 734 F.2d 1020, 1022 (4th Cir. 1984) (quoting Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 Minn. L. Rev. 439, 460 (1973). This issue is one of law that may be freely reviewed by successive courts.

Applying that test here, we conclude that the licensing agreement was at the critical time executory. RMF owed Lubrizol the continuing duties of notifying Lubrizol of

further licensing of the process and of reducing Lubrizol's royalty rate to meet any more favorable rates granted to subsequent licensees. By their terms, RMF's obligations to give notice and to restrict its right to license its process at royalty rates it desired without lowering Lubrizol's royalty rate extended over the life of the agreement, and remained unperformed. Moreover, RMF owed Lubrizol additional contingent duties of notifying it of suits, defending suits and indemnifying it for certain losses.

The unperformed, continuing core obligations of notice and forbearance in licensing made the contract executory as to RMF. In *Fenix Cattle Co. v. Silver (In re Select-A-Seat Corp.)*, 625 F.2d 290, 292 (9th Cir. 1980), the court found that an obligation of a debtor to refrain from selling software packages under an exclusive licensing agreement made a contract executory as to the debtor notwithstanding the continuing obligation was only one of forbearance. Although the license to Lubrizol was not exclusive, RMF owed the same type of unperformed continuing duty of forbearance arising out of the most favored licensee clause running in favor of Lubrizol. Breach of that duty would clearly constitute a material breach of the agreement.

Moreover, the contract was further executory as to RMF because of the contingent duties that RMF owed of giving notice of and defending infringement suits and of indemnifying Lubrizol for certain losses arising out of the use of the technology. Contingency of an obligation does not prevent its being executory under § 365. *See In re Smith Jones, Inc.*, 26 B.R. 289, 292 (Bankr. D. Minn. 1982) (warranty obligations executory as to promisor); *In re O.P.M. Leasing Services, Inc.*, 23 B.R. 104, 117 (Bankr. S.D.N.Y. 1982) (obligation to defend infringement suits makes contract executory as to promisor). Until the time has expired during which an event triggering a contingent duty may occur, the contingent obligation represents a continuing duty to stand ready to

perform if the contingency occurs. A breach of that duty once it was triggered by the contingency (or presumably, by anticipatory repudiation) would have been material.

Because a contract is not executory within the meaning of § 365(a) unless it is executory as to both parties, it is also necessary to determine whether the licensing agreement was executory as to Lubrizol. *See Bildisco*, —— U.S. at ——, 104 S. Ct. at 1194 n.6. We conclude that it was.

Lubrizol owed RMF the unperformed and continuing duty of accounting for and paying royalties for the life of the agreement. It is true that a contract is not executory as to a party simply because the party is obligated to make payments of money to the other party. *See Smith Jones*, 26 B.R. at 292; H. Rep. No. 95-595, 95th Cong., 2d Sess. 347, *reprinted in* 1978 U.S. Code Cong. & Ad. News 5963, 6303-04. Therefore, if Lubrizol had owed RMF nothing more than a duty to make fixed payments or cancel specified indebtedness under the agreement, the agreement would not be executory as to Lubrizol. However, the promise to account for and pay royalties required that Lubrizol deliver written quarterly sales reports and keep books of account subject to inspection by an independent Certified Public Accountant. This promise goes beyond a mere debt, or promise to pay money, and was at the critical time executory. *See Fenix Cattle*, 625 F.2d at 292. Additionally, subject to certain exceptions, Lubrizol was obligated to keep all license technology in confidence for a number of years.

Since the licensing agreement is executory as to each party, it is executory within the meaning of § 365(a), and the district court erred as a matter of law in reaching a contrary conclusion.*

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* We disagree with the district court's characterization of the transaction as effectively a completed sale of property. If an analogy

## III

There remains the question whether rejection of the executory contract would be advantageous to the bankrupt. *See Borman's, Inc. v. Allied Supermarkets, Inc.*, 706 F.2d 187, 189 (6th Cir. 1983). Courts addressing that question must start with the proposition that the bankrupt's decision upon it is to be accorded the deference mandated by the sound business judgment rule as generally applied by courts to discretionary actions or decisions of corporate directors. *See Bildisco*, —— U.S. at ——, 104 S. Ct. at 1195 (noting that the business judgment rule is the "traditional" test); *Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pacific Railroad*, 318 U.S. 523, 550 (1943) (applying business judgment rule to bankrupt's decision whether to affirm or reject lease); *Control Data Corp. v. Zelman (In re Minges)*, 602 F.2d 38, 43 (2d Cir. 1979) (applying *Institutional Investors* outside of railroad reorganizations); *Carey v. Mobil Oil Corp. (In re Tilco, Inc.)*, 558 F.2d 1369, 1372-73 (10th Cir. 1977) (applying *Institutional Investors* to rejection of gas contracts).

As generally formulated and applied in corporate litigation the rule is that courts should defer to—should not interfere with—decisions of corporate directors upon matters entrusted to their business judgment except upon a finding of bad faith or gross abuse of their "business discretion." *See, e.g., Lewis v. Anderson*, 615 F.2d 778, 782 (9th Cir. 1979); *Polin v. Conductron Corp.*, 552 F.2d 797, 809 (8th Cir. 1977). Transposed to the bankruptcy context, the rule as applied to a bankrupt's decision to reject an executory contract because of perceived busi-

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is to be made, licensing agreements are more similar to leases than to sales of property because of the limited nature of the interest conveyed. Congress expressly made leases subject to rejection under § 365 in order to "preclude any uncertainty as to whether a lease is an executory contract" under § 365. 2 *Collier on Bankruptcy* ¶ 365.02 (L. King 15th ed. 1984).

ness advantage requires that the decision be accepted by courts unless it is shown that the bankrupt's decision was one taken in bad faith or in gross abuse of the bankrupt's retained business discretion.

In bankruptcy litigation the issue is of course first presented for judicial determination when a debtor, having decided that rejection will be beneficial within contemplation of § 365(a), moves for approval of the rejection. The issue thereby presented for first instance judicial determination by the bankruptcy court is whether the decision of the debtor that rejection will be advantageous is so manifestly unreasonable that it could not be based on sound business judgment, but only on bad faith, or whim or caprice. That issue is one of fact to be decided as such by the bankruptcy court by the normal processes of fact adjudication. And the resulting fact determination by the bankruptcy court is perforce then reviewable up the line under the clearly erroneous standard. *See Minges*, 602 F.2d at 43; *see generally* 1 *Collier on Bankruptcy* ¶ 3.03(8)(b) (L. King 15th ed. 1984).

Here, the bankruptcy judge had before him evidence not rebutted by Lubrizol that the metal coating process subject to the licensing agreement is RMF's principal asset and that sale or licensing of the technology represented the primary potential source of funds by which might emerge from bankruptcy. The testimony of RMF's president, also factually uncontested by Lubrizol, indicated that sale or further licensing of the technology would be facilitated by stripping Lubrizol of its rights in the process and that, correspondingly, continued obligation to Lubrizol under the agreement would hinder RMF's capability to sell or license the technology on more advantageous terms to other potential licensees. On the basis of this evidence the bankruptcy court determined that the debtor's decision to reject was based upon sound business judgment and approved it.

On appeal the district court simply found to the contrary that the debtor's decision to reject did not represent a sound business judgment. The district court's determination rested essentially on two grounds: that RMF's purely contingent obligations under the agreement were not sufficiently onerous that relief from them would constitute a substantial benefit to RMF; and that because rejection could not deprive Lubrizol of all its rights to the technology, rejection could not reasonably be found beneficial. We conclude that in both of these respects the district court's factual findings, at odds with those of the bankruptcy court, were clearly erroneous and cannot stand.

A

In finding that the debtor's contingent obligations were not sufficiently onerous that relief from them would be beneficial, the district court could only have been substituting its business judgment for that of the debtor. There is nothing in the record from which it could be concluded that the debtor's decision on that point could not have been reached by the exercise of sound (though possibly faulty) business judgment in the normal process of evaluating alternative courses of action. If that could not be concluded, then the business judgment rule required that the debtor's factual evaluation be accepted by the court, as it had been by the bankruptcy court. *See Schein v. Caesar's World, Inc.*, 491 F.2d 17, 20 (5th Cir. 1974).

B

On the second point, we can only conclude that the district court was under a misapprehension of controlling law in thinking that by rejecting the agreement the debtor could not deprive Lubrizol of all rights to the process. Under 11 U.S.C. § 365(g), Lubrizol would be entitled to treat rejection as a breach and seek a money damages remedy; however, it could not seek to retain its contract rights in the technology by specific perform-

ance even if that remedy would ordinarily be available upon breach of this type of contract. *See In re Waldron*, 36 B.R. 633, 642 n.4 (Bankr. S.D. Fla. 1984). Even though § 365(g) treats rejection as a breach, the legislative history of § 365(g) makes clear that the purpose of the provision is to provide only a damages remedy for the non-bankrupt party. H. Rep. No. 95-595, 95th Cong., 2d Sess. 349, *reprinted* in 1978 U.S. Code Cong. & Ad. News 5963, 6305. For the same reason, Lubrizol cannot rely on provisions within its agreement with RMF for continued use of the technology by Lubrizol upon breach by RMF. Here again, the statutory "breach" contemplated by § 365(g) controls, and provides only a money damages remedy for the non-bankrupt party. Allowing specific performance would obviously undercut the core purpose of rejection under § 365(a), and that consequence cannot therefore be read into congressional intent.

IV

Lubrizol strongly urges upon us policy concerns in support of the district court's refusal to defer to the debtor's decision to reject or, preliminarily, to treat the contract as executory for § 365(a) purposes. We understand the concerns, but think they cannot control decision here.

It cannot be gainsaid that allowing rejection of such contracts as executory imposes serious burdens upon contracting parties such as Lubrizol. Nor can it be doubted that allowing rejection in this and comparable cases could have a general chilling effect upon the willingness of such parties to contract at all with businesses in possible financial difficulty. But under bankruptcy law such equitable considerations may not be indulged by courts in respect of the type of contract here in issue. Congress has plainly provided for the rejection of executory contracts, notwithstanding the obvious adverse consequences for contracting parties thereby made inevita-

ble. Awareness by Congress of those consequences is indeed specifically reflected in the special treatment accorded to union members under collective bargaining contracts, *see Bildisco*, —— U.S. at ——, 104 S. Ct. at 1193-96, and to lessees of real property, *see* 11 U.S.C. § 365(h). But no comparable special treatment is provided for technology licensees such as Lubrizol. They share the general hazards created by § 365 for all business entities dealing with potential bankrupts in the respects at issue here.

The judgment of the district court is reversed and the case is remanded for entry of judgment in conformity with that entered by the bankruptcy court.

*REVERSED AND REMANDED.*

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
RICHMOND DIVISION

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Civil Action No. 84-0074-R
In Bankruptcy No. 83-01047-R

IN RE: RICHMOND METAL FINISHERS, INC.

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[Filed April 27, 1984]

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OPINION AND ORDER

The motion of Richmond Metal Finishers, Inc., for leave to file a brief in opposition is GRANTED and the brief in opposition tendered and marked filed on 16 April 1984 is hereby FILED by leave of Court. The motion of Richmond Metal Finishers, Inc., for relief from judgment is DENIED for the reasons stated in the opinion filed herein on 3 April 1984 and for the reasons stated in the rebuttal brief of appellant filed on 26 April 1984.

And it is so ORDERED.

/s/ D. DORTCH WARRINER
United States District Judge

Date: 27 April 1984

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
RICHMOND DIVISION

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Civil Action No. 84-0074-R

In Bankruptcy No. 83-01047-R

IN RE: RICHMOND METAL FINISHERS, INC.

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[Filed April 3, 1984]

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## OPINION

Appellant Lubrizol Enterprises, Inc., seeks reversal of a decision by the Bankruptcy Court to permit the bankrupt Richmond Metal Finishers, Inc., to reject a contract between Lubrizol and Richmond. Richmond had developed certain valuable technology in the metal finishing trade. The technology involved the coating of metal with materials to make the metal more valuable for various uses. Richmond agreed to sell the technology to Lubrizol and Lubrizol agreed to pay a royalty on sales made by it through use of the technology.[1]

Richmond reserved the right to make similar transfers of the technology to others. Richmond was also obligated

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[1] While the terms of sale and purchase are more complicated than is written here, the essence is the same. Actually, Richmond was indebted to Lubrizol and the purchase price included the forgiveness of some of that indebtedness, forebearance as to portions of the indebtedness, and a credit against royalties as to the balance of the indebtedness.

under the contract to defend Lubrizol's right to the use and enjoyment of the technology by giving notice of any claims of invalidity and defending any claims of infringement.

At the time Richmond filed bankruptcy, no party had defaulted under the contract though no royalties had been paid or credited. A one-year prohibition against exploitation of the contract by Lubrizol had barely expired at the time bankruptcy was filed. Hence the absence of royalty payments was consistent with, not contrary to, the contract.

After filing bankruptcy, the debtor-in-possession sought to interest others in a similar contractual arrangement . Richmond was unsuccessful in these efforts and testified, through its president, that prospects showed no interest when he disclosed Lubrizol's involvement.

> I was trying to sell the technology, and all interested parties that looked at it backed off because it was not clear title to the technology. I mean, I disclosed the Lubrizol agreement and they said, Well, until we can get that straightened out—nobody would fund us, in other words.

Transcript, pp. 7-8.

The president did not do a good selling job. He did not disclose to prospects the agreement itself. The objection raised by the prospects, no clear title, which apparently ended negotiations, finds no support in the contract itself. It is specifically non-exclusive. Richmond had and has "clear title to the technology." Nothing need be "straightened out" with respect to the Lubrizol contract to enable other prospective purchasers of the technology full and free rights to exploit it in competition with Lubrizol, Richmond, or any other purchasers.

In any event, the debtor-in-possession, thinking he could get a better price if the technology were free of the claims

of Lubrizol, sought permission of the bankruptcy court to reject the Lubrizol contract. After briefing and oral argument the bankruptcy judge approved rejection. Lubrizol appealed and timely filed its brief. The time within which Richmond might have filed its reply brief has expired. The Court will consider the appeal on the present state of the record.

Lubrizol bases its appeal on two points: (1) the contract question is not executory, therefore it may not be rejected; (2) rejection of the contract does not benefit the estate since such rejection does not inhibit Lubrizol in its right to exploit the technology.

The Minnesota Law Review article by Vern Countryman, 57 Minn. L. Rev. 439 and 58 Minn. L. Rev. 479 apparently is the most current authority on what contracts are executory contracts for purposes of rejection in bankruptcy. Having studied Countryman's dissertation, I am satisfied that the inquiry is not nearly so simple as I thought it was when last I was conversant with the concept in Hardy Dillard's contracts class.

The parties refer to the contract as a licensing contract. Here is what Countryman says with respect to this genre:

> Where there is no express undertaking by the licensor, the agreement with the licensee may not be executory because the licensor may have fully performed merely by executing the license agreement. Thus a close question may be presented by a license to make and sell a patented product where another licensee undertakes to supply the product. Even in these close cases, however, there may be an implied undertaking by the licensor which brings all patent licenses within the ambit of an executory contract. It has been held in a patentee-licensor's infringement action against a third party that a final judgment adjudicating the

> patent invalid constitutes a "complete failure of consideration" amounting to an "eviction" which releases the licensee from any further obligation to pay royalties. Moreover, since the death of the doctrine of "licensee estoppel," the licensee can set up the invalidity of the patent as a defense when sued by the licensor for royalties due under the license. Hence, all patentee-licensors are now substantially in the position of having warranted to their licensees the validity of their patents. Although the sanction for the breach of such a warranty is only forfeiture of royalties rather than liability for damages, this continuing undertaking by the licensor is enough to justify the treatment of all unexpired patent licenses as executory contracts.

58 Minn. L. Rev. at 479. Professor Countryman cites as his only authority for this assertion Part I of his article at 57 Minn. L. Rev. 453.

His analysis is flawed by the fact that all of the cases available to him arose in the bankruptcy proceedings of a patent licensee. 58 Minn. L. Rev. at 504. The instant case, of course, involves bankruptcy of the licensor.

On the other hand he analyzed a number of cases much more nearly like the situation before the Court. These cases involve the sale of land. Especially analogous would be the sale of land with the retention of a purchase money deed of trust. There, as here, the subject of the contract has been conveyed and possession has been taken by the vendee. There, as here, the vendee has the obligation of making payment for the conveyance as provided in the contract. There, as here, the vendor has the benefit of receiving the periodic payments and has the *obligation* of defending the vendee's title. Despite the fact that the vendor in a purchase money deed of trust sale of real estate has the general warranty and English covenant obligations to the vendee, Countryman writes:

> In the great bulk of [purchase money mortgage] cases, where the credit is extended by a bank or other third-party lender who takes a mortgage from the vendee, the mortgagee-lender has performed its obligation when it makes payment to the vendor or otherwise advances the purchase money. Even in 'title theory' jurisdictions, no formal conveyance of title from mortgagee to mortgagor is required if the mortgagor repays the debt at maturity. Hence the mortgage should not be viewed as an executory contract which the bankruptcy trustee of either the mortgagee or the mortgagor can reject.
>
> In the rarer type of case, where the vendor of land is himself the purchase money mortgagee, including those cases where applicable non-bankruptcy law will treat the land sale contract as a mortgage, the situation seems no different. The vendor-mortgagee in either a title or lien theory state has fully performed when he has executed the deed and surrendered possession of the property. Ergo his mortgage also should not be treated as an executory contract. This analysis of the purchase money mortgage of realty, which is equally applicable to the nonpurchase money mortgage after the mortgagee has advanced all he is obligated to advance, has apparently appeared self-evident to the parties involved. There seems to be no recorded instance of attempted assumption or rejection by a receiver for or a trustee of either mortgagor or mortgagee.

The obligations of the vendor of real estate to defend the purchaser's title is no more onerous than the obligation of the vendor of technology to defend the vendee's right to exploit it. Nor is it a case where the obligation is merely implied in one case and is explicit in the instant case. The obligation is explicit in both cases.

*In Re The Select-A-Seat Corporation*, 625 F.2d 290 (9th Cir. 1980) is cited as pertinent to the inquiry. There

are a number of similarities between that case and the one before me. A major difference, however, is that Select-A-Seat had sold to Fenix an *exclusive* right to exploit the ticket-selling procedure at issue in the contract.

> Because of the exclusive nature of the license which Fenix received, Select-A-Seat was under a continuing obligation not to sell its software packages to other parties. Violation of this obligation would be a material breach of the licensing agreement. *Cf. In Re American Magnesium Co.*, 488 F.2d 147, 152 (5th Cir. 1974) (agreement to refrain from action as executory). The licensing agreement was executory; accordingly, the bankruptcy court properly considered the trustees' motion.

In the instant case, the conveyance to Lubrizol is not exclusive; Richmond has no obligation to refrain from licensing. Richmond does have the obligation of defending the title of Lubrizol, as did Select-A-Seat. Id. at 291. But this obligation was not cited by the court in *Select-A-Seat* as a basis for finding the contract executory. Quite properly not, since such a construction of the contract would hold all conveyances of real estate, other than a quit-claim deed, as an executory contract, an obvious absurdity.

It is clear that every case must be determined on the basis of the particular facts and circumstances of the case. There is no rule that all licensing contracts are executory. There is no rule that all sales of land are nonexecutory. The rule is to analyze the facts and circumstances of a given case and attempt to arrive at a decision as to whether in fact and in law a given case is more analogous to those where no executory contract has been found or more nearly analogous to those where an executory contract has been discerned. Applying this analysis and on the reasoning, (though not necessarily on the conclusion) of Professor Countryman, I find the contract to be essentially nonexecutory.

While it is not clear from the opinion below, I must assume that the order rejecting the contract was not intended to affect Lubrizol's ability to proceed to exercise its non-exclusive property right. Nor would rejection relieve Lubrizol of its obligation to pay the commission or royalty due. If this be the case, and it is difficult to conceive of the court having power in a summary proceeding to strip Lubrizol of the intellectual property it purchased from Richmond, then all the rejection would accomplish is to relieve Richmond of its residual obligation to defend Lubrizol's title. While it is conceivable that this obligation could be onerous, it is not onerous at the present time.[2] More to the point, the "business judgment" which prompted the rejection was the refusal of other prospects to consider purchasing the technology so long as the matter with Lubrizol was not "straightened out."

But the matter with Lubrizol *is* straight and I cannot see how removing Richmond's obligation to defend Lubrizol's title makes the technology any more marketable than it was before. There is no testimony that would support such a supposition. If Lubrizol had the right to assign the technology with the assignee having Richmond's obligation to defend the title as a part of the package it purchased, then, as to Lubrizol, the technology would be more marketable. But a termination of Richmond's obligation to Lubrizol would have, at best, a marginal effect upon the technology's marketability to others. Indeed, a defense of Lubrizol's title will redound to their benefit. Thus it appears to me that there is no burden nor is there any basis for the exercise of business judgment favorable to the rejection. There simply is nothing in the contract, objectively, which could hinder the debtor's reorganization.[3]

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[2] Moreover, Lubrizol in its brief purports to waive any obligations placed on Richmond by the contract.

[3] If a bankrupt had sold an asset and now wishes he had it back to re-sell at a better price, a "rejection" of the original sale would benefit the reorganization. But it would not be allowed.

Thus both on the ground that the contract is not executory and on the ground that its rejection will not benefit the estate, the contract should not be rejected.

The order is REVERSED and this action is REMANDED with directions to proceed accordingly.

And it is so ORDERED.

/s/ D. Dortch Warriner
United States District Judge

Date: 3 April 1984

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Richmond Division

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Bankruptcy Case No. 83-01047-R

IN RE: RICHMOND METAL FINISHERS, INC.,
*Debtor.*

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## MEMORANDUM OPINION

This matter came before the Court upon the filing of a motion for stay pending appeal by Lubrizol Enterprises, Inc. (Lubrizol) of a judgment by this Court regarding the rejection of an executory contract. After notice and hearing, and after submission of memoranda by counsel for the debtor, Richmond Metal Finishers, Inc. (RMF), and Lubrizol, this Court renders the following opinion.

## STATEMENT OF FACTS

On November 1, 1983, this Court entered an order pursuant to its Memorandum Opinion entered the same day granting the debtor's motion to reject its executory contract with Lubrizol. On November 10, 1983, upon motion by Lubrizol, this Court entered an order extending the time within which to file a notice of appeal to November 30, 1983. On November 30, 1983, Lubrizol filed in this Court a notice of appeal to the District Court. Also, on November 30, 1983, Lubrizol filed a motion for stay pending appeal. On December 19, 1983, after proper notice, a hearing was held on Lubrizol's motion for stay pending appeal.

At that hearing Lubrizol, by counsel, argued: 1) that on appeal they would in all likelihood prevail; 2) that there would be irreparable injury to them unless the stay

is granted; 3) that there would not be substantial harm to any other party in interest if the stay is granted; and 4) that if the stay is granted there would be no harm to the public interest. Lubrizol presented no evidence to support these four contentions except by way of cross examination of the witness testifying for RMF.

At that hearing on December 19, 1983, RMF established through the testimony of John Randall, a small business consultant, (1) that if the technology, which is the subject of the executory contract, is sold in early 1984, a cumulative cash flow in the amount of $171,000 in 1985, $330,000 in 1986, and $500,000 in 1987 would result from the company's operations including royalties from the technology; (2) that this culmulative cash flow would be after company expenses and, therefore, would be available to fund a reorganization plan; (3) that the debtor's reorganization efforts have already been harmed by delays in selling the technology; and (4) that if the technology cannot be sold within the next 12 months, RMF's reorganization will fail.

## CONCLUSIONS OF LAW

The issue presented here is whether this Court should grant Lubrizol a stay of this Court's November 1, 1983 judgment permitting RMF to reject its executory contract with Lubrizol.

A stay pending appeal is in the nature of a preliminary injunction. *In re Parr*, 1 B.R. 453 (Bkrtcy. E.D. N.Y. 1979); *In re Chanticleer Associates Ltd.*, 4 B.C.D. 509 (S.D. N.Y. 1978). Accordingly, in determining whether this Court should issue a stay pending appeal the Court will consider those factors used in determining whether a preliminary injunction should issue. Those factors are: 1) likelihood that a party seeking the stay will prevail on the merits of the appeal; 2) irreparable injury to the moving party unless the stay is granted; 3) no substantial harm to other interested parties; and 4) no harm to

the public interest. *In re Tolco Properties, Inc.*, 6 B.R. 490, 491 (Bkrtcy. E.D. Va. 1980). This four part standard has been nearly unanimously adopted by the federal courts in determining whether to grant a stay pending an appeal in bankruptcy matters. *See e.g. Long* v. *Robinson*, 432 F.2d 977, 979 (4th Cir. 1970); *In re White Motor Corp.*, 25 B.R. 293, 297 (N.D. Ohio 1982); *In re Wymer*, 5 B.R. 802, 806 (Bkrtcy. 9th Cir. 1980); *In re Beck*, 26 B.R. 945, 946 (Bkrtcy. N.D. Ohio 1983); *In re Richardson*, 15 B.R. 930, 931 (Bkrtcy. E.D. Pa. 1981); *see also Schwartz* v. *Covington*, 341 F.2d 537 (9th Cir. 1968).

Some courts have required that all four aspects of the above outlined standard be established before granting a stay pending appeal. *See In re Beck*, 26 B.R. at 947; *In re Sung Hi Lim*, 7 B.R. 319, 321 (Bkrtcy. D. Hawaii 1980). Other courts, however, have applied a balancing test wherein every aspect of the four part standard need not be established. Those courts have held that a stay pending appeal is appropriate if in balancing the four criteria the equities mandate that a stay be granted. *See, In re Pagoda International, Inc.*, 26 B.R. 18 (Bkrtcy. D Md. 1982); *In re Richardson*, 15 B.R. at 931. Without deciding which approach is required, this Court will discuss all four aspects of the standard in determining whether to grant or deny Lubrizol's motion for a stay pending appeal.

Lubrizol has argued unpersuasively that they will likely prevail on the merits on appeal. Lubrizol has not cited to this Court any new authority or authority not discussed previously by this Court to prompt this Court to reverse its opinion of November 1, 1983. There is considerable law addressing the issues of rejection of executory contracts. A reconsideration of that authority demonstrates that there is a general agreement as to the appropriate standards in approving a motion for rejection of an executory contract. This Court's opinion of

November 1, 1983, is consistent with and, in fact, is mandated by those authorities.

Some courts have held that where a divergence of legal authority or case law on a particular question exists, a stay pending appeal is appropriate because the issue of the appellant's likelihood to prevail on the merits of an appeal is significant. *See In re Dobslaw*, 20 B.R. 922, 924 (Bkrtcy. E.D. Pa. 1982); *In re Tenfield, Inc.*, 12 B.R. 14, 15 (Bkrtcy. E.D. Va. 1981). In the instant matter, however, Lubrizol has not demonstrated that divergence of authority exists on this issue. Nor has Lubrizol identified any significant errors in this Court's opinion of November 1, 1983, to convince this Court that they would likely prevail on appeal. Therefore, this Court holds that Lubrizol is not likely to prevail on the merits of an appeal.

Lubrizol argues that it will suffer irreparable harm unless the stay is granted because third parties may obtain rights to the subject technology which could prevent or hinder Lubrizol from exercising its rights under the agreement in the event Lubrizol prevails on appeal. By this Lubrizol means that if a stay is denied RMF may grant to another party an exclusive license to the technology. This is Lubrizol's only argument that they will be irreparably injured.

Any injury that might result to Lubrizol is in the nature of contract damages only. This Court believes that the type and character of injury contemplated by the applicable standard as "irreparable" is something of greater severity than normal contract damages. Case law reveals that irreparable injury has been found by courts in situations such as where a party would be incarcerated if a stay pending appeal is not granted. *See In re Tenpins Bowling, Ltd.*, 32 B.R. 474, 484 (Bkrtcy. M.D. Ga. 1983). Contract damages are not irreparable, Lubrizol may file timely a proof of claim and share in any distributions under the debtor's reor-

ganization plan or in liquidation if the debtor's case is converted to one under Chapter 7.[1] It is also significant to note that Lubrizol may be unable to prove any damages in this case. At the time the debtor brought the motion to reject the executory contract with Lubrizol, Lubrizol had not exercised any of its rights under the contract by which profit was generated for Lubrizol or RMF. With these things in mind, this Court concludes that Lubrizol has not shown that they will be irreparably harmed if the judgment of this Court is not stayed pending appeal.

The third aspect of the applicable standard is whether substantial harm to the other interested parties will occur if the stay is or is not granted. Lubrizol argues that because the technology which is subject to the agreement is not security for any debt no other party will be harmed if a stay pending appeal is granted. Apparently, Lubrizol is correct in stating that there is no secured party that would be harmed if a stay pending appeal was granted. However, this Court recognizes that there are other interested parties that may be harmed if the stay is granted.

As stated by the debtor in his brief and as established by the evidence presented at the debtor's motion for rejection of an executory contract, the technology license agreement is the debtor's principal asset without which a reorganization of the debtor is impossible. The evi-

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[1] Courts that have found irreparable harm have also required a showing of a likelihood of success on the merits of an appeal before granting a stay. *See, e.g., In re Babco, Inc.*, 25 B.R. 325 (W.D. Pa. 1982); *In re Sing Hi Lim*, 7 B.R. 319 (Bkrtcy. D. Hawaii 1980). Therefore, even if this Court was to hold that Lubrizol will incur irreparable harm because the debtor may potentially end up as a no-asset Chapter 7 estate, the requested stay should be denied because Lubrizol must at least demonstrate a likelihood of success on the merits in conjunction with such irreparable harm (which they have failed to do) in order for this Court to grant the requested stay.

dence established further that a need to act promptly existed in order to reorganize the debtor, and that in light of the absence of any prior payments by Lubrizol to RMF under the license agreement there is a greater likelihood of an infusion of cash to aid the debtor's reorganization if the contract is rejected. Therefore, to stay this Court's judgment of November 1, 1983, may be the death nell of the debtor's reorganization efforts with a corresponding loss to the creditors, particularly the unsecured creditors of RMF who will most likely receive less in liquidation than they would had RMF been permitted to gain confirmation and consummation of a plan of reorganiaztion. *See In re Old South Coors, Inc.*, 30 B.R. 412, 413 (N.D. Miss. 1983). With these observations in mind, this Court holds that creditors of RMF are "other interested parties" that will be harmed if the requested stay is granted.

Finally, Lubrizol argues that a stay is in the public interest. As a basis for this contention, Lubrizol states that it is in the public interest that RMF be forestalled from ostensibly granting rights to technology when its power to do so is unclear or uncertain. The Court is not convinced that RMF's power to grant its technology rights to other parties is unclear or uncertain. RMF rejected its executory contract with Lubrizol pursuant to authority explicitly provided by the Bankruptcy Code. 11 U.S.C. § 365. With the contract rejected RMF is now free to grant any or all of its rights to the technology because it is no longer affected by an existing valid agreement with another party (i.e. Lubrizol).

This Court is uncertain whether the aspect of the public interest in the analysis outlined above is applicable to the instant case. Most often an analysis of the public interest in granting or denying a preliminary injunction involves a threat to the public as a whole such as an environmental problem, a labor dispute or possibility of cessation of utility or public services. Therefore, this Court does not believe that much weight, if any, should

be given to the parties' contentions as to what is the public interest in this matter.

If there is a public interest in this matter, it is seeing that the purposes and policies of the Bankruptcy Code are not frustrated particularly the underlying policy of bankruptcy law to help reorganize debtors and provide a "fresh start." In this regard any "public interest" weighs against granting the stay. *Cf. In re Intermet Realty Partnership*, 27 B.R. at 940 (where the U.S. Bankruptcy Court in considering whether to grant a stay pending appeal stated that the debtor's "assertion that without this property the debtor will be unable to fund a plan of reorganization and satisfy claims of creditors lends weight to the argument [that the stay should be denied] so ably advanced by the debtor." *Id.*)

In the instant matter, the evidence has established that if this Court grants Lubrizol a stay pending appeal and, thereby, prohibits RMF, Inc. from disposing of technology that constitutes its principal asset, the reorganization of RMF will, in all likelihood, be impossible. Thus, this Court concludes that to grant the stay would permit Lubrizol to relitigate matters already decided by this Court and frustrate the debtor's rehabilitation. Lubrizol has failed to cite to this Court authority for granting a stay pending appeal in this matter and has not convinced this Court by argument that a stay is appropriate. Therefore, the Court concludes that a stay of the November 1, 1983 judgment of this Court should not and will not be stayed by this Court during the pendency of the appeal taken by Lubrizol from that judgment.

An appropriate Order will issue.

ENTER:

/s/ Blackwell N. Shelley
United States Bankruptcy Judge

January 5th, 1984
Richmond, Virginia

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Richmond Division

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Bankruptcy Case No. 83-01047-R

IN RE: RICHMOND METAL FINISHERS, INC.,
*Debtor.*

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ORDER

For the reasons stated in the Memorandum Opinion issued and entered this same date, it is hereby

ORDERED that the motion for stay pending appeal by Lubrizol Enterprises, Inc. be and hereby is denied and it is further

ORDERED that Richmond Metal Finishers, Inc., debtor, be and hereby is permitted to dispose of the technology that is subject to the technology license agreement discussed in the Opinion accompanying this Order and in this Court's Opinion of November 1, 1983, in accordance with the Opinion and decision of November 1, 1983.

The Clerk is directed to forward a copy of this Order to counsel of record.

ENTER:

/s/ Blackwell N. Shelley
United States Bankruptcy Judge

January 5, 1984
Richmond, Virginia

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Richmond Division

---

Bankruptcy Case No. 83-01047-R

IN RE: RICHMOND METAL FINISHERS, INC.,
*Debtor.*

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## MEMORANDUM OPINION

This matter came before the Court on the debtor's motion to reject an executory contract. After proper notice this Court held a hearing on the debtor's motion. After careful consideration of the evidence presented and the briefs submitted by the parties, this Court renders the following opinion.

## STATEMENT OF FACTS

On July 8, 1982, the debtor, Richmond Metal Finishers, Inc. ("RMF") and Lubrizol Enterprises, Inc. ("Lubrizol") executed a contract which is referred to by the parties as "Technology License Agreement" (the agreement). By the terms of the contract, RMF grants to Lubrizol a nonexclusive license to specified technology owned by RMF. RMF's other obligations under the agreement include: (1) notifying Lubrizol of any patent infringement suit and defending such suit; (2) notifying Lubrizol if RMF intends to make any other use or license of the technology; (3) defending Lubrizol in any patent infringement case brought against Lubrizol for their use of the technology under the license agreement; and (4) holding Lubrizol harmless and indemnifying them from certain loss or liability specified under the contract. In return for the license and RMF's other un-

dertakings, Lubrizol, among other obligations contained in the contract, agreed to pay a royalty to RMF for its use of the technology, and to cancel some existing indebtedness owed to Lubrizol by RMF.

On August 16, 1983, RMF filed a petition pursuant to Chapter 11 of the Bankruptcy Code in this Court. The debtor in possession, pursuant to § 365 of the Code, brought this action to reject the contract. A hearing on the debtor's motion to reject was held on September 7, 1983. Lubrizol appeared by counsel and opposed the debtor's motion.

In support of its motion, RMF's president, W. W. Robinson testified. He stated that RMF had received no payments from Lubrizol under the agreement and had no assurance that future royalties would be forthcoming under that contract. Mr. Robinson testified further that the technology subject to the nonexclusive license agreement is RMF's principal assets and that attempts to sell or license the technology to other purchasers is hindered by the existing contract with Lubrizol even though nonexclusive. Finally, he stated that to fund properly RMF's Chapter 11 plan the sound business decision is to reject the license agreement with Lubrizol.

## CONCLUSIONS OF LAW

Under the Bankruptcy Code the trustee may assume or reject executory contracts or unexpired leases provided the court approves such rejection or assumption. 11 U.S.C. § 365. Counsel for the debtor in possession, possessing the same rights as a trustee pursuant to 11 U.S.C. § 1107, has sought such court approval. Said § 365 provides in pertinent part:

> (a) . . . the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.
>
> . . .

> (d) (2) In a case under Chapter . . . 11 . . . of the title, the trustee may assume or reject an executory contract or unexpired lease of the debtor at any time before confirmation of a plan . . . .

This Court, therefore, is faced with two issues, both which if resolved in favor of the debtor in possession will lead this Court to grant the relief requested—i.e. the debtor may reject the license agreement with Lubrizol. First, § 365 only permits the court to approve rejection or assumption of executory contracts, thus if the license agreement before the Court is not an executory contract, this Court will not approve rejection. Second, if the contract sought to be rejected is executory, this Court must decide whether to approve such rejection and by what standards it should consider such approval.

*Is the Lubrizol agreement an executory contract?*

Lubrizol argues that the execution of the license agreement and the delivery to Lubrizol by RMF of certain manuals constitute all the debtor's (RMF) obligations and because these have been performed the contract is not executory as to the debtor. In addition, Lubrizol contends that all of their obligations have been performed fully or substantially thereby leaving no performance on the part of Lubrizol. Absent performance due by either party, Lubrizol argues that the contract is not executory and therefore cannot be rejected.

RMF, the debtor, on the other hand argues that substantial performance by both parties remains and, therefore, the contract is executory and may be rejected if this Court so approves. Specifically, RMF alleges that the following performance is required still:

1) RMF must pay Lubrizol $10,000.00.

2) RMF must advise Lubrizol of any patent infringement case and must defend any such case filed against Lubrizol.

3) RMF must advise Lubrizol of any other use of the technology, which is subject of the License Agreement, and accept a reduced royalty because of such additional use.

4) RMF must indemnify and hold harmless Lubrizol from loss or liability under the License Agreement.

Unfortunately, the Code does not define executory contract. The Legislative History to § 365, however, does provide:

> . . . Though there is no precise definition of what contracts are executory, it generally includes contracts on which performance remains due to some extent on both sides.

H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 347 (1977); S. Rep. No. 95-989, 95th Cong., 2nd Sess. 58 (1978). Professor Countryman and others have attempted to add clarity to the problem of determining whether a contract is executory. *See, e.g.*, Countryman, *Executory Contracts in Bankruptcy*, 57 Minn. L. Rev. 439 (1973) (Part I), 58 Minn. L. Rev. 479 (1974) (Part II). What appears clear by the applicable case law is that each court must undertake an independent analysis of the particular contract at hand. No simple formula exists to be applied in every situation, rather each contract must be interpreted in light of the existing guidelines but also with an eye towards furthering the policies of the Bankruptcy Code. The United States Court of Appeals for the Sixth Circuit has stated:

> The key, it seems, to deciphering the meaning of the executory contract rejection provisions, is to work backward, proceeding from an examination of the purposes rejection is expected to accomplish. If those objectives have already been accomplished, or if they can't be accomplished through rejection, then the contract is not executory within the meaning of the Bankruptcy Act.

*In re Jolly*, 574 F.2d 349, 351 (6th Cir. 1978). In order to aid a debtor in its rehabilitation efforts, bankruptcy courts apply standards that are more flexible than those under contract law. *See, In re Rovine*, 6 B.R. 661, 664 (Bkrtcy. W.D. Tenn. 1980).

Without adopting a specific test, and with an eye towards prior case law, the legislative history, Professor Countryman's approach and the policies underlying the Bankruptcy Code, this Court is satisfied that the subject contract is executory if both Lubrizol and RMF have some continuing obligation that if unperformed would be a material breach of contract.

At the very least, Lubrizol may be obligated to pay RMF a royalty for its use of RMF's technology under the license agreement. This obligation exists for 16 years and constitutes a substantial part of the consideration given by Lubrizol to procure the license agreement. Consequently, this Court holds that Lubrizol has contract obligations still to be performed. Moreover, Lubrizol's failure to pay royalties as they may fall due would constitute a material breach of the agreement.

Lubrizol's obligation is very similar to Fenix's obligation in *In re Select-A-Seat*, 625 F.2d 290 (9th Cir. 1980) where Fenix, like Lubrizol here, was challenging the debtor's motion to reject an executory contract. There Fenix was obligated to pay an initial fee plus five percent of its annual net return from use of the debtor's computer software. The United States Court of Appeals for the Ninth Circuit stated in *Select-A-Seat* that "if Fenix failed to make these annual payments, that failure would constitute a material breach of the contract, justifying revocation of the exclusive license." 625 F.2d at 292.

Admittedly, *Select-A-Seat* involved an *exclusive* license agreement, however, the court in *Select-A-Seat* found Fenix, the licensee, to have a continuing obligation with-

out regard to the issue of the agreement's exclusive nature. In other words, Fenix's failure to make annual royalty payments would constitute a material breach even if the license agreement in *Select-A-Seat* was nonexclusive. *See id.* Similarly, the Bankruptcy Court for the Western District of Tennessee held that an obligation to make royalty payments under a franchise agreement made the contract executory as to the party objecting to the attempted rejection. *In re Rovine Corp.*, 6 B.R. 661, 665 (1980). The court stated further that such franchise agreements are in many respects, similar to a license. *Id.*

Having held that the license agreement provides for a continuing obligation as to Lubrizol and that case law adequately supports this holding, this Court will also determine whether RMF owes some continuing and material obligation before holding the contract to be executory for purposes of 11 U.S.C. § 365. Lubrizol argues that RMF has performed fully its obligations under the license agreement by executing the agreement and by delivering certain manuals and other materials to Lubrizol. RMF, however, has produced evidence demonstrating that they have certain continuing obligations under the agreement.

Testimony by the president of the debtor and the terms of the agreement itself demonstrate that RMF owes Lubrizol some continuing, even if contingent, obligations. First, RMF must advise Lubrizol of any challenge to the patent rights that are subject to the agreement. Second, RMF must defend, at its expense, any patent infringement action brought against Lubrizol involving the subject technology. Finally, RMF must hold Lubrizol harmless and indemnify them for certain loss or liability specified under the contract. These obligations, although contingent, are sufficient to make the contract executory as to RMF. Moreover, these obligations are not *de minimis*. They are important aspects of the consideration received by Lubrizol, thus RMF's failure to honor them would constitute a material breach of the license agreement.

Courts have held that merely because an obligation is contingent it does not prevent the contract from being executory for purposes of § 365. *In re Smith Jones, Inc.*, 26 B.R. 289, 292 (Bkrtcy. D. Minn. 1982). If, as Lubrizol alleges, all obligations of the parties have been performed except for the payment of money by Lubrizol, the contract would not be executory. However, even obligations that may never arise may form the basis of classifying a contract as executory. The court in *Smith Jones* held that the debtor's express warranty obligations fell within the definition of "executory contracts" and satisfied the requirement that an executory contract have "bilateral involvement." *Id.* Moreover, the obligation to defend a license from patent infringement suits and to indemnify said licensee from infringement claims was enumerated specifically by the Bankruptcy Court for the Southern District of New York in *In re O.P.M. Leasing Services, Inc.*, 23 B.R. 104, 117 (Bkrtcy. S.D.N.Y. 1982) as an obligation sufficient to make a contract executory.

Finally, Professor Countryman's discussion of executory contracts adds to the aforementioned authorities supporting this Court's determination that the license agreement between Lubrizol and RMF is an executory contract. Countryman states:

> The usual patent license, by which the patentee—licensor authorizes the licensee to exercise some part of the patentee's exclusive right to make, use and vend the patented item in return for payment of royalties, ordinarily takes the form of an executory contract.

Countryman, *Executory Contracts in Bankruptcy*, 58 Minn. L. Rev. 479, 501 (1974). Therefore, although RMF did not have a final patent on the subject technology, the following conclusions can be drawn: the usual patent license is an executory contract and even though there is no implied warranty of a valid patent in this matter, RMF made express undertakings in the license

agreement that constitute a continuing, contractual obligation.

*Should the proposed rejection be approved?*

Having held the license agreement to be an executory contract, this Court must now decide whether to approve the debtor in possession's proposed rejection of the contract.

The Code itself provides no express guidelines for this Court to apply in determining whether to permit a debtor to reject an executory contract. The Code provides only that court approval is required. Under the old Bankruptcy Act and some cases under the new Code, courts have said that the contract sought to be rejected must be "burdensome" to the debtor for the court to approve rejection. Another approach involves collective bargaining agreements and it examines whether in attempting to reject a collective bargaining agreement the court should undertake an "equitable balancing" of the relative benefits and detriments to the debtor and other party affected by any rejection of the contract. Finally, the more modern and preferable approach is the business judgment test which provides that rejection should be approved if it will benefit the estate.

This Court is satisfied that in the instant case, which does not involve a collective bargaining agreement, the appropriate test is the "business judgment" approach. It has been followed by numerous Circuit, District, and Bankruptcy Courts. *See e.g., Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific R. Co.*, 318 U.S. 523, 550 (1943); *Barman's Inc.* v. *Allied Supermarkets, Inc.*, 706 F.2d 187, 189 (6th Cir. 1983); *In re Minges*, 602 F.2d 38, 43 (2nd Cir. 1979); *Matter of Tilco*, 558 F.2d 1369, 1372 (10th Cir. 1977); *In re Chi-Fing Huang*, 23 B.R. 798, 800 (Bkrtcy. 9th Cir. 1982); *In re O.P.M. Leasing Services, Inc.*, 23 B.R. 103, 118

(Bkrtcy. S.D. N.Y. 1982); *In re Sombrero Reef Club, Inc.*, 18 B.R. 612, 617 (Bkrtcy. S.D. Fla. 1982); *In re Lafayette Radio Electronics Corp.*, 8 B.R. 528, 533 (Bkrtcy. E.D. N.Y. 1981).

Under the business judgment test a court should approve the debtor's proposed rejection if such rejection will benefit the estate. *In re Minges*, 602 F.2d at 43; *In re Sombrero Reef Club, Inc.*, 18 B.R. at 617. Some courts have suggested that the Court's role in this determination is minimal, and that rejection should be denied only where the trustee's or debtor in possession's decision is clearly erroneous. *In re Sombrero Reef Club, Inc.*, 18 B.R. at 617; *see also, In re Summit Land Co.*, 13 B.R. 310, 315 (Bkrtcy. D. Utah 1981). Similar to the matter before this Court, *Sombrero Reef* involved a debtor's motion to reject contracts that adversely affected its principal asset. Although this Court holds that the debtor in possession's decision to reject is not clearly erroneous, as evidenced by the discussion below, it will nonetheless apply the business judgment test to the particular facts at hand to determine whether the rejection should be approved.

Counsel for Lubrizol argues that the contract should not be rejected because it does not burden the debtor and further that rather than burden the debtor, the contract represents a future stream of income and, therefore, rejection will not benefit the estate. As to Lubrizol's first argument, this Court has noted earlier that the burdensome test is not the appropriate one to be applied here. In fact, courts have held consistently that rejection may and should be approved where a contract, while not actually burdensome to the debtor nonetheless prevents the debtor from entering a more advantageous arrangement. *In re Smith Jones, Inc.*, 26 B.R. at 293.

Mr. Robinson testified for RMF, as its president, that the technology that was the subject of the license agree-

ment with Lubrizol was the debtor's principal asset. He testified further that in endeavoring to fund the debtor's Chapter 11 plan he was attempting to sell or license the technology, but that the existing nonexclusive agreement hindered those efforts. He stated that interested purchasers were concerned with the existing license arrangement with Lubrizol and would be more likely to purchase rights to the technology if RMF was free of its obligations to Lubrizol and the technology was not encumbered by an outstanding license agreement. Finally, Mr. Robinson stated that he believed it was an exercise of good business judgment to reject the contract.

Mr. Robinson's testimony was uncontradicted. Further, Lubrizol did not demonstrate that any royalty payments had been made or would be forthcoming in the future. Consequently, this Court holds that rejection of the license agreement will benefit the estate and aid the debtor's efforts at reorganization because such rejection will permit RMF to substitute the existing license arrangement with a new one that is more advantageous to the estate and the creditors of RMF. Such benefit to the estate and unsecured creditors is the court's primary concern in applying the business judgment test. *In re Chi-Feng Huang*, 23 B.R. 798, 801 (Bkrtcy. 9th Cir. 1982). Whether one party is injured or rejection is "unfair" to a party is an inappropriate analysis. *Id.* at 800. The policies of the Bankruptcy Code encourage the Chapter 11 debtor to substitute marginal or burdensome arrangements for those that will benefit the estate. *Group of Institutional Investors* v. *Chicago Milwaukee, St. Paul & Pacific R. Co.*, 318 U.S. 523 (1943). *In re Summit Land Co.*, 13 B.R. 310, 315 (Bkrtcy. D. Utah 1981).

The Court's holding, however, does not leave Lubrizol without a remedy. Lubrizol has a claim for breach of contract. Like other prepetition creditors Lubrizol has the right to file timely a proof of claim and share in any

distribution under the Chapter 11 plan, if confirmed, or under Chapter 7 liquidation, if this proceeding is later converted.

The "business judgment" test being satisfied, this Court should grant and approve the debtor's motion to reject the executory contract between itself (RMF) and Lubrizol.

An appropriate Order will issue.

ENTER:

/s/ Blackwell N. Shelley
United States Bankruptcy Judge

November 1, 1983
Richmond, Virginia

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Richmond Division

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Bankruptcy Case No. 83-01047-R

IN RE: RICHMOND METAL FINISHERS, INC.,
*Debtor.*

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ORDER

For the reasons stated in the Memorandum Opinion entered this same date, it is hereby

ORDERED that the debtor's motion to reject its executory contract with Lubrizol Enterprises, Inc. be and hereby is approved and granted.

The Clerk is directed to forward a copy of this Order to counsel of record.

ENTER:

/s/ Blackwell N. Shelley
United States Bankruptcy Judge

November 1, 1983
Richmond, Virginia

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

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No. 84-1539

LUBRIZOL ENTERPRISES, INC.,
*Appellee,*

versus

RICHMOND METAL FINISHERS, INC.,
*Appellant.*

IN RE: RICHMOND METAL FINISHERS, INC.,
*Debtor.*

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[Filed Mar. 15, 1985]

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Appeal from the United States District Court
for the Eastern District of Virginia

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JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Eastern District of Virginia, and was argued by counsel.

On consideration whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court appealed from, in this cause, be, and the same is hereby, reversed and the case is remanded for entry of judgment in conformity with that entered by the bankruptcy court.

/s/ John M. Greacen
Clerk

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

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No. 84-1539

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LUBRIZOL ENTERPRISES, INC.,
*Appellee*

versus

RICHMOND METAL FINISHERS, INC.,
*Appellant*

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[Filed Aug. 22, 1985]

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ORDER

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On a request for a poll of the court on the petition for rehearing en banc, those voting for rehearing en banc were Judges Russell, Widener, Hall, Chapman and Sneeden, while those voting against rehearing en banc were Chief Judge Winter and Judges Phillips, Murnaghan, Sprouse, Ervin and Wilkinson.

It is accordingly ADJUDGED and ORDERED that the petition for rehearing en banc shall be, and it hereby is, denied.

The panel, consisting of Judges Phillips, Wilkinson and Butzner, has considered the petition for rehearing and is of opinion it is without merit.

It is accordingly ADJUDGED and ORDERED that the petition for rehearing shall be, and it hereby is, denied.

It is further ORDERED that the motions of the Sperry Corporation and Licensing Executives Society, Inc. to appear amicus curiae shall be, and they hereby are, denied.

/s/ H. E. Widener, Jr.
For the Court

Filed August 22, 1985

Bankruptcy Reform Act of 1978

§ 365, 11 U.S.C. § 365 (1982)

Executory contracts and unexpired leases

(a) Except as provided in sections 765 and 766 of this title [dealing with commodity broker liquidation] and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.

(b)(1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee—

(A) cures, or provides adequate assurance that the trustee will promptly cure, such default;

(B) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any actual pecuniary loss to such party resulting from such default; and

(C) provides adequate assurance of future performance under such contract or lease.

(2) Paragraph (1) of this subsection does not apply to a default that is a breach of a provision relating to—

(A) the insolvency or financial condition of the debtor at any time before the closing of the case;

(B) the commencement of a case under this title;

or

(C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.

(3) For the purposes of paragraph (1) of this section, adequate assurance of future performance of a lease of

real property in a shopping center includes adequate assurance—

(A) of the source of rent and other consideration due under such lease;

(B) that any percentage rent due under such lease will not decline substantially;

(C) that assumption or assignment of such lease will not breach substantially any provision, such as radius, location, use, or exclusivity provision, in any other lease, financing agreement, or master agreement relating to such shopping center; and

(D) that assumption or assignment of such lease will not disrupt substantially any tenant mix or balance in such shopping center.

(4) Notwithstanding any other provision of this section, if there has been a default in an unexpired lease of the debtor, other than a default of a kind specified in paragraph (2) of this subsection, the trustee may not require a lessor to provide services or supplies incidental to such lease before assumption of such lease unless the lessor is compensated under the terms of such lease for any services and supplies provided under such lease before assumption of such lease.

(c) The trustee may not assume or assign an executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if—

(1) (A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to the trustee or an assignee of such contract or lease, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and

(B) such party does not consent to such assumption or assignment; or

(2) such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor.

(d) (1) In a case under chapter 7 of this title, if the trustee does not assume or reject an executory contract or unexpired lease of the debtor within 60 days after the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such contract or lease is deemed rejected.

(2) In a case under chapter 9, 11, or 13 of this title, the trustee may assume or reject an executory contract or unexpired lease of the debtor at any time before the confirmation of a plan, but the court, on request of any party to such contract or lease, may order the trustee to determine within a specified period of time whether to assume or reject such contract or lease.

(e) (1) Notwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on—

(A) the insolvency or financial condition of the debtor at any time before the closing of the case;

(B) the commencement of a case under this title; or

(C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.

(2) Paragraph (1) of this subsection does not apply to an executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if—

(A) (i) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to the trustee or to an assignee of such contract or lease, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and

(ii) such party does not consent to such assumption or assignment; or

(B) such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor.

(f) (1) Except as provided in subsection (c) of this section, notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease under paragraph (2) of this subsection.

(2) The trustee may assign an executory contract or unexpired lease of the debtor only if—

(A) the trustee assumes such contract or lease in accordance with the provisions of this section; and

(B) adequate assurance of future performance by the assignee of such contract or lease is provided, whether or not there has been a default in such contract or lease.

(3) Notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable

law that terminates or modifies, or permits a party other than the debtor to terminate or modify, such contract or lease or a right or obligation under such contract or lease on account of an assignment of such contract or lease, such contract, lease, right, or obligation may not be terminated or modified under such provision because of the assumption or assignment of such contract or lease by the trustee.

(g) Except as provided in subsections (h)(2) and (i)(2) of this action, the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease—

(1) if such contract or lease has not been assumed under this section or under a plan confirmed under chapter 9, 11, or 13 of this title, immediately before the date of the filing of the petition; or

(2) if such contract or lease has been assumed under this section or under a plan confirmed under chapter 9, 11, or 13 of this title—

(A) if before such rejection the case has not been converted under section 1112 or 1307 of this title, at the time of such rejection; or

(B) if before such rejection the case has been converted under section 1112 or 1307 of this title—

(i) immediately before the date of such conversion, if such contract or lease was assumed before such conversion; or

(ii) at the time of such rejection, if such contract or lease was assumed after such conversion.

(h)(1) If the trustee rejects an unexpired lease of real property of the debtor under which the debtor is the lessor, the lessee under such lease may treat the lease

as terminated by such rejection, or, in the alternative, may remain in possession for the balance of the term of such lease and any renewal or extension of such term that is enforceable by such lessee under applicable nonbankruptcy law.

(2) If such lessee remains in possession, such lessee may offset against the rent reserved under such lease for the balance of the term after the date of the rejection of such lease, and any such renewal or extension, any damages occurring after such date caused by the nonperformance of any obligation of the debtor after such date, but such lessee does not have any rights against the estate on account of any damages arising after such date from such rejection, other than such offset.

(i) (1) If the trustee rejects an executory contract of the debtor for the sale of real property under which the purchaser is in possession, such purchaser may treat such contract as terminated, or, in the alternative, may remain in possession of such real property.

(2) If such purchaser remains in possession—

(A) such purchaser shall continue to make all payments due under such contract, but may, offset against such payments any damages occurring after the date of the rejection of such contract caused by the nonperformance of any obligation of the debtor after such date, but such purchaser does not have any rights against the estate on account of any damages arising after such date from such rejection, other than such offset; and

(B) the trustee shall deliver title to such purchaser in accordance with the provisions of such contract, but is relieved of all other obligations to perform under such contract.

(j) A purchaser that treats an executory contract as terminated under subsection (i) of this section, or a

party whose executory contract to purchase real property from the debtor is rejected and under which such party is not in possession, has a lien on the interest of the debtor in such property for the recovery of any portion of the purchase price that such purchaser or party has paid.

(k) Assignment by the trustee to an entity of a contract or lease assumed under this section relieves the trustee and the estate from any liability for any breach of such contract or lease occurring after such assignment.

Bankruptcy Reform Act of 1978

§ 502(g), 11 U.S.C. § 502(g) (1982)

Allowance of claims or interests

A claim arising from the rejection, under section 365 of this title or under a plan under chapter 9, 11, or 13 of this title, of an executory contract or unexpired lease of the debtor that has not been assumed shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

## TECHNOLOGY LICENSE AGREEMENT

AGREEMENT made the 8th day of July, 1982, by and between LUBRIZOL ENTERPRISES, INC., a corporation of Nevada, whose office and mailing address is 29400 Lakeland Boulevard, Wickliffe, Ohio 44092, hereinafter called "LZ"; and RICHMOND METAL FINISHERS, INC., whose principal office and mailing address is 326 West 7th Street, Richmond, Virginia 23224, hereinafter called "RMF".

WITNESSETH:

WHEREAS, RMF represents that it is in the business of developing technologies including improving coated metallic articles and processes for providing metallic articles with wear-resistant coatings, and

WHEREAS, RMF represents that it has developed certain coated metallic articles and processes for providing metallic articles with wear-resistant coatings and has acquired know-how and other proprietary technology related thereto, and

WHEREAS, RMF further represents that one or more embodiments of said coated metallic articles and certain processes for providing metallic articles with wear-resistant coatings are disclosed and claimed in application for United States Letters Patent, Serial No. 328913 filed 12-9-81 and entitled "Process for Providing Metallic Articles and the Like with Wear-Resistant Coatings, and Improved Coated Metallic Articles and the Like" and

WHEREAS, RMF warrants that it is the sole owner of the entire right, title and interest in and to the aforesaid Patent Application, Serial No. 328913 and in said know-how and other proprietary technology related thereto and has the right to grant the license set forth in this Agreement, and that none of such rights have been encumbered, and

WHEREAS, LUBRIZOL ENTERPRISES, INC., a wholly owned subsidiary of THE LUBRIZOL CORPORATION, 29400 Lakeland Boulevard, Wickliffe, Ohio 44092, has entered into certain business arrangements and agreements with RMF whereby RMF has presently outstanding obligations to LZ for (a) $77,000 representing certain advances made by LZ to RMF during Phase I of their relationship, which obligation is evidenced by an interest-bearing promissory note dated July 7, 1981 ("Phase I Note"), (b) $88,244 representing certain advances made by LZ to RMF during Phase IA of their relationship, which obligation is evidenced by an interest-bearing promissory note dated December 31, 1981 ("Phase IA Note") and (c) $15,000 representing expenditures made by LZ for certain reports relating to their former program, which obligation is represented by an interest-bearing promissory note dated December 31, 1981 (the "$15,000 Note"), and

WHEREAS, LZ and RMF have agreed that in consideration of the surrender of the Phase IA Note, RMF will grant to LZ a non-exclusive, royalty-bearing, worldwide, assignable, license to (1) RMF's technology made or developed up to the end of the Phase IA period of April 1, 1982 including any inventions whether patented or not and, if patented, no matter when these patents issue and (2) all inventions disclosed and claimed in RMF's U.S. Patent Application, Serial No. 328913 filed 12-9-81 and the know-how and technology relating thereto.

NOW, THEREFORE, in consideration of the mutual covenants herein set forth, the parties agree as follows:

ARTICLE I. *DEFINITIONS*

(1) The term "affiliate of LZ" as used in this Agreement shall mean any company of which LZ now or hereinafter owns or controls, directly or indirectly, 35% or more of the stock having the right to vote for directors

thereof. For the purpose of this definition, the stock owned or controlled by LZ shall be deemed to include all stock owned or controlled, directly or indirectly, by any other company of which LZ now or in the future owns or controls, directly or indirectly, 35% or more of the stock having the right to vote for the directors thereof.

(2) "Licensed Technology" shall mean all RMF proprietary technology made or developed up to the end of Phase IA, including all techniques, inventions, practices, knowledge, skill, experience and other oral or written information including without limitation all plans, drawings, blueprints, specifications, process specifications, and the like which is owned or controlled by RMF whether or not the subject of letters patent or of applications for letters patent and shall include technology relating to coated metallic articles and processes for providing metallic articles with wear-resistant coatings whether or not the subject of letters patent or of applications for letters patent. "Licensed Technology" shall, without limiting the generality of the foregoing, include all matters heretofore disclosed by RMF to LZ and all matters to be disclosed pursuant to Article III(1), but shall not include any proprietary technology, whether entirely new or in the nature of improvements, which RMF demonstrates through laboratory notebooks or other legally competent written evidence that was made or developed after the end of Phase IA.

(3) "Licensed Patent(s)" shall mean any and all Letters Patent owned or controlled by RMF, the inventions of which were invented or developed up to the end of Phase IA and the claim or claims of which cover Licensed Technology or any reissues or substitute applications therefor and any patents issuing thereon; and any corresponding applications for letters patent in other countries; any letters patent issuing upon said applications or related applications and reissues of or patents of addition relating thereto and further shall mean and include U.S.

Patent Application No. 328913 filed 12-9-81 entitled "Process for Providing Metallic Articles and the Like with Wear-Resistant Coatings and Improved Coated Metallic Articles and the Like", any continuations, divisions, and continuations-in-part, thereof or any reissues or substitute applications therefor and any patents issuing thereon; and any corresponding applications for letters patent in other countries; any letters patent issuing upon said applications or related applications and reissues of or patents of addition relating thereto.

(4) "Licensed Product(s)" shall mean any process, machine, manufacture and/or composition of matter (1) emboding the Licensed Technology and/or (2) covered by one or more claims in a Licensed Patent(s).

(5) "Net Selling Price" shall be the full amount paid to LZ for each Licensed Product by purchasers therefrom less any returns and allowances, freight charges, sales tax, excise tax or use taxes, commissions, cash discounts or custom duties; nor shall the Net Selling Price include any other charges not directly attributable to the Licensed Product(s). In the case of a sale by LZ or LZ's customers in which a Licensed Product is only one component of a package, the Net Selling Price of such component shall be determined by multiplying the Net Selling Price of the entire package by the ratio which the standard factory cost of the component bears to be the standard factory cost of the entire package. A sale by a sublicensee or assignee of LZ shall be treated for purposes of this Agreement as a sale by LZ. If LZ shall sell Licensed Products to any subsidiary or other affiliates, the Net Selling Price for purposes of this Agreement shall be the price paid to such subsidiary or affiliates upon resale of such licensed products to an unaffiliated third party or, if such Licensed Products are not resold, shall be the price quoted by LZ to unaffiliated third parties for similar licensed products.

(6) "First Commercial Sale" is the first sale which occurs after a Licensed Product first appears in either a LZ or The Lubrizol Corporation's subsidiaries, divisions or affiliates Products publication.

ARTICLE II. *LICENSE GRANT*

(1) RMF hereby grants LZ, subject to the terms set forth in this Agreement, a non-exclusive, assignable, worldwide right and license to use, make, have made and sell Licensed Product(s) and to use all of the Licensed Technology and Licensed Patents.

(2) LZ may sublicense and/or assign its rights hereunder in whole or in part to The Lubrizol Corporation, The Lubrizol Corporation's subsidiaries, divisions and/or affiliates.

ARTICLE III. *TECHNICAL INFORMATION*

(1) Immediately upon the execution of this Agreement, RMF shall disclose to LZ, all of the Licensed Technology.

(2) LZ agrees that all RMF Licensed Technology received at any time under this Agreement from RMF shall be kept in confidence by LZ until seventeen years from the end of the Phase IA period except that LZ may use the confidential information for the purposes of carrying out this Agreement.

LZ and RMF agree that no Licensed Technology shall be considered confidential and LZ shall not be limited in disclosing or using the same if and to the extent that the information:

(i) was already known to LZ free of any obligation of confidence at the time of its receipt from RMF, and LZ can document this by written legally competent evidence; or

(ii) is, or becomes through no fault of LZ, in the public domain.

ARTICLE IV. *PAYMENTS*

LZ agrees:

(1) As consideration for the use of RMF's Licensed Technology (except Licensed Technology that has become public knowledge through no fault of LZ or which was known to LZ prior to RMF's disclosures and can be documented by written legally competent evidence by LZ as such), LZ shall pay to RMF on sales from the period beginning on the date of LZ's First Commercial Sale of any Licensed Product and ending on the 17th anniversary of the end of Phase IA, subject to the other terms and conditions of this Agreement, a royalty of five percent (5%) of the Net Selling Price of each Licensed Product sold by LZ further provided, however, that only one royalty shall be due on each Licensed Product even when said Licensed Product is manufactured in one country and sold or used in other countries, and after said 17th anniversary, LZ shall be free to make, use and sell the Licensed Product in any country free of any royalty or other payment whatsoever to RMF subject to the terms and conditions set forth in this Agreement. The payment under Article IV(3) is hereby credited against future earned royalties, whenever earned.

(2) To pay to RMF a royalty of five percent (5%) of the Net Selling Price of each Licensed Product used or sold by LZ provided that such manufacture, use or sale infringes one or more valid and enforceable claims of any unexpired Licensed Patent in the country of manufacture, use or sale; further provided, however, that only one royalty shall be due on each Licensed Product even when said Licensed Product is manufactured in one country and sold or used in other countries where the sale or use infringes one or more valid and enforceable claims of an unexpired Licensed Patent in said other countries. Upon expiration or abandonment of the last to expire or abandoned Licensed Patent, LZ shall be free to use, make,

have made, and sell the Licensed Product in any country free of any royalty or other payment whatsoever to RMF subject to the terms and conditions set forth in this Agreement. The payment under Article IV(3) is hereby credited against future earned royalties, whenever earned. The five percent (5%) royalty payable under the provisions of this paragraph is in lieu of the five percent (5%) royalty defined in Article IV(1).

(3) Upon execution and delivery of this Agreement by both LZ and RMF, LZ shall surrender to RMF the Phase IA Note dated December 31, 1981, whereupon LZ shall receive a credit equal to the outstanding unpaid principal balance of the Phase IA Note of $86,244 against any future earned royalties whenever earned as provided in Article IV(1) or IV(2) herein.

(4) Only a single royalty shall be due on the sale of any Licensed Product(s) regardless of the number of Licensed Patents or Licensed Technology covering or relating to said Licensed Product(s).

(5) If LZ is required to take a license under a third-party patent in order to continue to make, have made, use or sell a Licensed Product, then the royalty under Article IV(1) or IV(2) herein shall be paid in accordance with the provisions of Article X(6) hereunder.

ARTICLE V. *ROYALTY REPORTS AND PAYMENTS*

(1) Following the First Commercial Sale of a Licensed Product, LZ shall deliver to RMF a written report within thirty (30) days following the end of each calendar quarter subsequent to said commercial sale stating the total sales of Licensed Products during such quarter. The royalties payable to RMF hereunder shall accompany each such report.

(2) Following the First Commercial Sale of any Licensed Product, LZ shall keep full and true books of account and other records in sufficient detail so that the

royalties payable to RMF hereunder can be properly ascertained. At the request of RMF, LZ shall permit an independent Certified Public Accountant acceptable to both parties to inspect said books and records a maximum of one (1) time per year during reasonable business hours at RMF's expense. In order to protect LZ's confidential business information, the report of such accountant to RMF shall be confined to statements regarding the accuracy of royalty payments made by LZ. The parties agree that the acceptance of said accountant shall not be unreasonably withheld.

ARTICLE VI. *DEFERMENT OF PAYMENT*

LZ agrees to defer all payments of principal and interest on the Phase I Note and the $15,000 Note held by LZ for a 12-month period beginning May 1, 1982 and ending May 1, 1983 so that RMF will be out of default on these two notes for that 12-month period. LZ also agrees to reduce the principal balance due on the $15,000.00 note to $10,000.00 in order that the note cover only the approximate expenses paid by LZ to Boris Haskell for the patentability study of RMF technology. RMF shall have the option to obtain the Arthur D. Little report within the 12-month deferred period upon paying the sum of Five Thousand Dollars ($5,000.00) to LZ.

ARTICLE VII. *DEFERMENT OF USE BY LZ OF THIS LICENSE OR RMF'S TECHNOLOGY*

LZ agrees not to make use of this license, Licensed Technology and/or Licensed Patents for a 12-month period beginning May 1, 1982 and ending May 1, 1983.

ARTICLE VIII. *PURCHASE OF THIS AGREEMENT*

If within a 12-month period beginning May 1, 1982 and ending May 1, 1983, RMF or a new investor in RMF offers to buy this license for a price equal to the then

outstanding principal balance of the Phase I Note, the Phase IA Note and the $15,000 Note plus accrued interest thereon to the date of payment, LZ will assign all of LZ's interest in this license and in said three notes to RMF or said new investor upon such payment by RMF or said new investor to LZ. For purposes of this Article, the outstanding principal balance of the Phase I Note shall be $77,000, the outstanding principal balance of the Phase IA Note shall be $86,244, and the outstanding principal balance of the $15,000 Note shall be $15,000 (subject to Article VI herein), in each case reduced only by cash payments in respect of such principal.

ARTICLE IX. *PAYMENT OF RMF'S $15,000 NOTE HELD BY LZ*

RMF agrees to pay LZ $10,000 within a 12-month period beginning May 1, 1982 and ending May 1, 1983 (subject to Article VI herein), whereupon LZ agrees to (1) surrender said RMF's $15,000 note and (2) furnish RMF with a written report by Boris Haskell, Esq. concerning a patentability study of RMF's technology which was conducted by Boris Haskell for LZ and (3) to furnish RMF with a copy of Boris Haskell's bills concerning this study.

ARTICLE X. *INFRINGEMENT OF THIRD PARTY PATENTS*

(1) In the event of the institution of any suit against RMF and/or LZ, its affiliates, divisions, subsidiaries or customers, alleging that the manufacture, use or sale of the Licensed Product(s) infringes any patent rights of a third party, the party against whom the action is being taken, will give the other party written notice of any such third party suits within thirty (30) days from the institution of such a suit.

(2) In the event that LZ is threatened with suit or is sued for patent infringement based on the Licensed Prod-

uct(s), RMF shall upon request from LZ, defend such suit at RMF's expense insofar as such alleged patent infringing activities may be involved.

(3) LZ may at LZ's option defend against any third party infringement suits and/or LZ may at LZ's option join with RMF in any action RMF may take in defending against third party infringement suits.

(4) If it becomes necessary for LZ to defend against such third party suit or LZ so elects to join RMF in defending against such a third party infringement suit, then each party shall be responsible for its own expenses.

(5) RMF agrees, if requested by LZ and at LZ's expense, to furnish to LZ all information, assistance and testimony which LZ considers necessary in connection with any such infringement of any third party patent suits to which LZ is a party as set forth in this Article.

(6) If LZ is required to take a license under a third party patent in order to continue to make, have made, use or sell the Licensed Product, up to fifty percent (50%) of the earned royalties due RMF may be set off against royalties due a third party.

(7) If it becomes necessary for LZ to defend against third party infringement suits, LZ may, at LZ's option, have complete control of any such litigation and/or negotiations to any such infringement of third party patent suits to which LZ is a party as set forth in this Article.

ARTICLE XI. *INFRINGEMENT BY THIRD PARTY OF LICENSED PATENT*

(1) If either party discovers a Licensed Patent being infringed by a third party, the party discovering the infringement shall notify the other party in writing within thirty (30) days following the discovery of such infringement.

(2) In the event of substantial infringement of any of the Licensed Product(s) in any country by the manufacture, use or sale of Licensed Product(s), and LZ gives written notice of such infringement to RMF, and if, within six (6) months following the date of such notice, such infringement has not ceased, or RMF has not filed suit in any appropriate court to enjoin such infringement, then payment of royalties under Article IV herein shall not be required as to sales of such licensed products in those countries where they are being substantially infringed for the period commencing with the end of said six (6) month period and continuing until such infringement ceases, or until RMF files suit to enjoin the same. However, RMF shall not be required to maintain more than one such suit in any one country at any one time.

(3) LZ may at LZ's option bring an action against any unlicensed infringing third party and/or LZ may at LZ's option join RMF in any action RMF may take against any unlicensed infringing third party.

(4) If it becomes necessary for LZ, at LZ's option and in LZ's judgment, to bring an action against any unlicensed third party and/or LZ elects, at LZ's option to join such third party suits brought by RMF against an unlicensed infringing third party then each party shall be responsible for its own expenses.

(5) RMF agrees, if requested by LZ and at LZ's expense, to furnish to LZ all information, assistance and testimony which LZ considers necessary in connection with any such third party infringement suits to which LZ is a party.

(6) If it becomes necessary for LZ, in LZ's judgment, to bring or to join an action against any unlicensed infringing third party, LZ may, at LZ's option, have complete control of any such litigation and/or negotiations to any such unlicensed infringing third party suits to which LZ is a party as set forth in this Article.

(7) Any recovery received by LZ in any suit brought by LZ under a Licensed Patent in LZ's name, in RMF's name or in both LZ's and RMF's names shall be the sole property of LZ. If both LZ and RMF have joined the suit then any recoveries received by either party shall be apportioned as follows: firstly, to pay reasonable litigation expenses before any other expenses; secondly, to pay reasonable litigation support expenses, if any, to the party joining the suit; and then, to pay the balance remaining equally between the parties.

ARTICLE XII. *MOST FAVORED LICENSEE*

In the event that RMF has granted or in the future grants a license under Licensed Patent(s), Licensed Technology and/or to the Licensed Product(s) to another to make, have made, use and/or sell the technology which is the subject of this Agreement on royalty terms more favorable to the new licensee than those herein provided, LZ's royalty shall be automatically adjusted to the more favorable term effective as of the date the more favorable terms were given to another. RMF represents and warrants that if it was granted, or in the future grants, a license on royalty terms more favorable than those herein provided, it will give LZ notice thereof in writing within thirty (30) days.

ARTICLE XIII. *TERM AND TERMINATION*

(1) This Agreement shall terminate with the expiration or abandonment of the last to expire or abandoned Licensed Patent or if no patent issues to RMF 17 years from the end of Phase IA if not otherwise terminated as provided herein.

(2) LZ shall have the right to terminate this Agreement after the 12-month period beginning May 1, 1982 and ending May 1, 1983 by giving RMF sixty (60) days notice in writing of such termination, and upon the ex-

piration of said sixty (60) days this Agreement shall automatically be terminated.

(3) If and whenever any party shall default in the performance of any of the provisions of this Agreement and the default shall continue unremedied for a period of sixty (60) days after receipt of written notice by the party in default, then upon the expiration of said sixty (60) day period the party giving said notice may, at its own option, terminate this Agreement by written Notice of Termination to the defaulting party. If this Agreement is terminated by reason of default by LZ, the licenses granted in Article II shall terminate; if this agreement is terminated by reason of default by RMF, such licenses shall not terminate and LZ shall have no further obligation to pay royalties hereunder.

(4) Any termination of this Agreement shall not discharge either party from any liabilities occurring prior to the effective date of such termination. LZ shall provide RMF within sixty (60) days of such termination, with a final royalty report if such report would be required under Article V herein accompanied by any royalties due.

(5) In the event that a Court of competent jurisdiction from which no appeal is or can be taken shall decree that a Licensed Patent(s) is to be limited or is invalid, LZ upon giving written notice thereof to RMF shall have the right to follow such decree, and the obligations of LZ hereunder thereafter shall be limited in accordance with such decree. RMF agrees to notify LZ promptly of any such decree.

(6) Any termination of this Agreement shall not discharge either party from any liability or continuing obligation with respect to Article III herein.

ARTICLE XIV. *GENERAL PROVISIONS*

(1) RMF hereby warrants that to the best of its knowledge and belief, it is completely vested with all

right, title and interest in and to the Licensed Technology and Licensed Patent(s), and that it has the full right, without any restraint or limitation or obligation from anyone of any kind whatsoever, to grant the present license to LZ and to fully perform its obligations hereunder. RMF also warrants that the patents, patent applications, certificates of invention as well as other forms of intellectual property rights identified in Article I hereof are the only patents, patent applications, certificates of invention and other forms of the intellectual property rights that come within the definitions of "Licensed Technology" or "Licensed Patents" and which are owned, controlled or under which RMF is able to grant licenses thereunder.

(2) RMF further agrees to indemnify and hold LZ harmless for any losses or liabilities which LZ may incur, directly or indirectly, as a result of any misrepresentation or breach of any warranty set forth herein.

(3) All notices to be sent hereunder shall be in writing and shall for all purposes be deemed to be fully given and received when forwarded by paid first class mail to the respective parties at the following addresses:

Richmond Metal Finishers, Inc.
326 West 7th Street
Richmond, Virginia 23224

Lubrizol Enterprises, Inc.
29400 Lakeland Boulevard
Wickliffe, Ohio 44092

Attn: R. John Senz

Either party may change its address by written notice duly given to the other party.

(4) This Agreement shall be interpreted and construed and any legal relations created hereunder shall be determined in accordance with the laws of the State of Ohio.

(5) Neither this Agreement or any other rights and powers created hereunder may be assigned, in whole or in part, by RMF without the prior written consent of LZ, which consent shall not be unreasonably withheld.

(6) This Agreement embodies the entire understanding between the parties as to a Technology License concerning RMF's proprietary technology, patents, inventions and know-how, and supersedes the references to and provisions concerning a license contained in the proposals entered into between LZ and RMF relating to Phases I, IA and II and related documentations and this Agreement is executed and delivered upon the basis of this understanding. No alteration, waiver or change in any of the terms hereof subsequent to the execution hereof claimed to have been made by any representative of either party shall have any force or effect unless in writing signed by the parties hereto or their duly authorized agents or representatives.

IN WITNESS WHEREOF, the parties have executed this Agreement effective as of the day and year indicated above.

LUBRIZOL ENTERPRISES, INC.

By: /s/ R. John Senz

Title: Vice President

RICHMOND METAL FINISHERS, INC.

By: /s/ W. W. Robinson

Title: President

(5)

No. 85-863

Supreme Court, U.S.
FILED
JAN 8 1986
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1985

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LUBRIZOL ENTERPRISES, INC.,

*Petitioner,*

v.

ROBERT A. CANFIELD, BANKRUPTCY TRUSTEE FOR RICHMOND METAL FINISHERS, INC.,

*Respondent.*

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**On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit**

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## BRIEF IN OPPOSITION

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## STATEMENT

Respondent agrees with the Statement of material facts and relevant proceedings in the courts below as supplied by the Petitioner.

## SUMMARY OF ARGUMENT

1. Lubrizol has raised in its petition for *certiorari* for the first time the contention that the subject licensing agreement constituted a sale of the technology by RMF. That issue was not raised by Lubrizol in any court below, and should not be raised for the first time in this Court.

2. Rejection of the licensing agreement neither rescinds a contract, nor deprives Lubrizol of any proprietory interest in property. Rejection merely terminates a right of use, as would be the result if a debtor landlord rejected a tenant's lease.

3. This case does not raise an important issue of federal law. Licensing agreements are the type Congress contemplated could be rejected under Section 365.

## REASONS A WRIT SHOULD NOT BE GRANTED

### 1. Lubrizol Raises an Issue on Appeal not Heard in the Court Below.

Lubrizol contends on brief that the Technology Licensing Agreement concluded a sale by RMF to Lubrizol of the technology. Petitioner's Brief, p. 6, note 5.

At no time in any of the courts through which this litigation has traversed has Lubrizol ever contended

it purchased the technology from RMF. In fact, on the petition for rehearing and suggestion for rehearing Lubrizol filed in the court below, Lubrizol conceded that the subject technology licensing agreement was executory.

Therefore, since this issue was not raised in any court below, the Supreme Court of the United States should not grant the Petitioner a writ of *certiorari* for consideration of this issue. *Carlson v. Green*, 446 U.S. 14 (1980).

**2. Rejecting the Subject Licensing Agreement Does Not Rescind a Property Transfer.**

The thrust of and foundation for the assertion that an error of law has occurred is the mistaken belief of Lubrizol Enterprises, Inc. (Lubrizol) that the subject licensing agreement effected a pre-petition transfer of the proprietory interest of Richmond Metal Finishers, Inc. (RMF), in its metal finishing technology to Lubrizol. That assertion is now, and has been throughout the litigation in the Courts below, erroneous.

RMF never parted with its title to or ownership of the technology; Lubrizol contracted for nothing greater than the right to use the technology, and the use licensed was "non-exclusive" at that. No transfer of title or ownership to the technology ever passed from RMF to Lubrizol. The contract only authorized Lubrizol to use a part of RMF's entire right to make, use and vend the technology. Technology Licensing Agreement, Article II, Petitioner's Appendix, 55a. RMF never ceased to own the technology until its case became a Chapter 7 proceeding.

Therefore, Lubrizol is under a fundamental misconception as it analyzes the impact of Section 365 of

the Bankruptcy Code upon the rejected licensing agreement. This case is not, as Lubrizol would have the Court believe, about the divestiture of a proprietory interest in property; it is about the termination of a mere right of use.

Licensing agreements are more like leases than any other type of executory contract. The licensor is like a landlord who contractually grants his licensee/tenant a limited right to use his property for a specified purpose or purposes, over a stated term for certain consideration. Therefore, as the Court of Appeals below correctly noted, it is more accurate to analyze this case as though the licensing agreement were a lease to which RMF was the landlord and Lubrizol the tenant. Petitioner's Appendix, pp. 5a-6a, footnote.

Congress recognized that rejection of an executory contract or a lease under Section 365 could, under certain circumstances, strip a non-debtor party of limited rights to use property. If a landlord under a lease of real property who was in a Chapter 11 or Chapter 13 proceeding sought to reject a lease pursuant to Section 365, the effect of the rejection upon his tenant would be to deprive him of his right to continued use of the leased premises. Congress provided special protections for tenants of real properties whose leases were rejected, but absent those prophylactic provisions the rejecting landlord would recover his property for the unused term of the lease. Congress did not provide special protections for licensing agreements such as that at bar.

Rejection of the licensing agreement in this case does not deprive Lubrizol of any interest in property that was not contemplated by the drafters of the Bankruptcy Code. Lubrizol's interest in the technol-

ogy has never risen higher than a right of use, and that is an interest which Congress determined a debtor had the right to recover when it enacted Section 365. RMF has never sought the recovery of any manuals or other tangible property transferred to Lubrizol when the licensing agreement was executed; its sole object has been to terminate Lubrizol's right to use the technology.

**3. The Decision of the Court Below Does Not Raise a New Issue That Must be Settled by This Court.**

The decision of the Court of Appeals below does not raise any important issue of federal bankruptcy law which has not already been settled by this Court.

The subject of executory contracts, the power of a debtor to reject them under the Bankruptcy Code, and the expansive definition of executory contracts Congress adopted when enacting the Bankruptcy Code has previously been addressed by this Court. *N.L.R.B. v. Bildisco and Bildisco,* U.S. ___, 104 S.Ct. 1188 (1984). The language of the Code "includes all executory contracts except those expressly exempted . . . ." *Bildisco,* 104 S.Ct. at 1194. Licensing agreements are no where excluded from the operation of Section 365, and Congress knew how to draft exemptions from its operation. *Bildisco,* 104 S.Ct. at 1195.

Contrary to the arguments advanced by various *amici,* the licensing agreement is executory. Petitioner's Brief, 3, note 3. Additionally, a denial of *certiorari* will not hamper business or industry growth. It will simply mean that inventors will have

to sell technological advancements to developers who wish to limit their risks, and that developers will be denied the favorable tax advantages that flow from licensing. Developers can either take the risk of having inventors file bankruptcy and reject their licensing agreement, or limit their risk by purchasing a technology outright and paying a little more tax.

## CONCLUSION

The petition for a writ of *certiorari* should be denied. The Petitioner did not raise in any court below the argument that it owned the subject technology. The decision of the Court of Appeals below neither expands the power of a debtor to reject a contract that is clearly executory, nor does it deprive the Petitioner of any proprietory interest in property.

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No. 85-863

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1985

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LUBRIZOL ENTERPRISES, INC.,
*Petitioner*,

v.

ROBERT A. CANFIELD, BANKRUPTCY TRUSTEE FOR RICHMOND METAL FINISHERS, INC.,
*Respondent*.

---

**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit**

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## REPLY BRIEF FOR PETITIONER

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**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit**

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## REPLY BRIEF FOR PETITIONER

---

### INTRODUCTION

Petitioner Lubrizol Enterprises, Inc. ("Lubrizol") submits this reply brief to correct the misstatement of the history of this case contained in Respondent's Brief in Opposition, to clarify the nature of the interests that would be jeopardized if the decision below is left uncorrected, and to emphasize the importance of this Court deciding this case in view of the blind adherence which the decision below has already received even where it is not the controlling law.

## ARGUMENT

### I. Lubrizol Is Not Raising a New Issue in This Court.

The central issue in this case is and has been whether a bankruptcy debtor in possession or trustee (collectively "DIP"), can, as a result of its rejection of a contract under § 365 of the Bankruptcy Code (the "Code"), deprive a party to such contract of the benefit of the partial performance of the contract rendered by the debtor prior to its bankruptcy filing. The focus of this case, then, is and has been Lubrizol's continuing rights in unpatented technological information (the "Technology") which was disclosed by Richmond Metal Finishers, Inc. ("RMF") to Lubrizol more than a year prior to RMF's bankruptcy filing, pursuant to the agreement which RMF has sought to reject in this case (the "Agreement").

Respondent argues that Lubrizol is raising for the first time the question whether a pre-petition transfer of the Technology to Lubrizol occurred under the Agreement. This contention is inexplicable, since the Fourth Circuit stated that it disagreed with the District Court's conclusion that the transfer of the Technology was "effectively a completed sale of property." Pet. App. at 5a-6a n.*; 756 F.2d at 1046 n.*. The District Court also addressed this issue. *See* Pet. App. at 12a; 38 Bankr. at 342. Obviously, an issue addressed by both the District Court and the Court of Appeals, and central to the disposition of the matter by each court, is not newly raised in the present petition.

In further support of his claim that Lubrizol did not previously argue that a completed transfer had occurred under the Agreement, Respondent argues that Lubrizol conceded below that the Agreement was executory.[1] This

[1] Lubrizol made that concession in its Petition for Rehearing to the court below solely for purposes of argument in that petition. *See* Petition for Rehearing and Suggestion of Rehearing in Banc

is a *non sequitur*. Implicit in this argument is the obviously incorrect assumption that no transfer could be complete under a contract which is still executory. This was the erroneous premise underlying the conclusion of the Fourth Circuit that Lubrizol was seeking specific performance, when in reality Lubrizol simply sought to protect itself against rescission. This is the fallacy that this Court should correct to prevent § 365 from being widely used to achieve an end never intended by Congress.

Under the prevailing understanding of the term "executory" as used in § 365, a contract need not be wholly unperformed to be an "executory contract" subject to rejection. All that is required is that "performance remains due to some extent on both sides." *N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513, 522 n.6 (1984). Thus it is quite possible to have a contract under which a transfer has been completed, but sufficient executory obligations remain to render the contract executory for the purposes of § 365.

The Agreement here is such a contract; an initial transfer occurred, but contingent performance obligations remained on both sides. *See* Pet. at 3. Any sales agreement with mutual covenants surviving the transfer of property is an executory contract under these criteria. *See e.g., In re Smith Jones, Inc.*, 26 Bankr. 289 (Bankr. D. Minn. 1982).

It is precisely because such executory obligations can, and often do, co-exist with completed transfers of property that this Court should grant the petition in this case. The court below has held that the existence of executory obligations, even if contingent, together with a DIP's

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at 3. Likewise, in its Petition for Certiorari Lubrizol has not raised the issues of proper definition of "executory", nor whether the Agreement is executory. *See* Pet. at 9, n.7.

"business judgment" that rejection is beneficial, is a sufficient basis for rescission of the pre-bankruptcy property transfer. Such a result is both unprecedented and clearly inappropriate.

## II. A Completed Transfer of Property Occurred Under the Agreement for which § 365 Does Not Provide a Right of Rescission.

Respondent attempts to avoid the fundamental question raised in Lubrizol's Petition: Can § 365 be used as the basis for divesting property transferred by the debtor prior to its bankruptcy filing? Respondent fails to meet the contention that such divestiture is not proper under § 365.

Instead, Respondent contends in his brief that RMF had not transferred property to Lubrizol, arguing that the Agreement is more like a lease. Br. in Opp. at 2-3. Yet RMF did not dispute in the courts below, Pet. App. at 30a; 34 Bankr. at 523, and does not dispute here, Br. in Opp. at 1, that it carried out its obligations under the Agreement to disclose the Technology to Lubrizol. Furthermore, under the Agreement, Lubrizol's right to possess the disclosed Technology never ends. *See* Agreement Article XIII(6), Pet. App. at 63a (obligations of disclosure and confidentiality survive any termination of Agreement). Under these circumstances, the analogy to a lease is flawed. *See* Pet. at 6 n. 5; *see also* Nimmer, The Law of Computer Technology ¶ 5.02[3] (1985) (conveyance of a trade secret is not mere license).

In fact, this transfer is neither lease nor sale, but is a transfer of rights, sui generis, governed by state contract and trade secret law. *See Aronson v. Quick Point Pencil Co.*, 440 U.S. 257 (1979) (state contract law relative to trade secrets is not preempted by federal patent law); *Kewanee Oil Co. v. Bicron Corp.* 416 U.S. 470 (1974) (state trade secret law is not preempted by federal patent law). Under such law, once such secret

information is disclosed without restriction or limitation, a party lawfully possessing the information may exploit it in perpetuity. *See Ruckelshaus v. Monsanto Co.*, 104 S. Ct. 2862, 2873 (1984).

Rejection of the Agreement by RMF would place Lubrizol effectively in the same position as one to whom disclosure was made without restriction. This is necessarily the case because the only restrictions are embodied in the Agreement on which neither the Trustee nor RMF can rely after rejection. Respondent is urging that § 365 of the Bankruptcy Code provides a means for the DIP to recapture what it has disclosed. This would amount to an unwarranted injunction against Lubrizol forbidding it from using the Technology when there exists no basis under either the Code or under state trade secret law supporting such relief.

Both Respondent and the courts below have overlooked the clear import of the Code: This is to treat rejection under § 365 as a breach of contract by the DIP and to apply non-bankruptcy law to ascertain the legal consequences of the breach, making unavailable, however, specific performance. 11 U.S.C. §§ 365(g), 502(g). The Code does not go any further. The court below has construed § 365 to provide remedies to the DIP of rescission and injunction which neither the statute, its legislative history nor sound public policy permits.

### III. The Question Presented in This Case Has Not Been Previously Decided by This Court and Should Be Decided to Avoid Significant and Unnecessary Damage to Businesses in the United States.

Respondent's statement that "the subject of executory contracts . . . has previously been addressed by this Court," citing *N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513 (1984), is accurate but hardly significant. *Bildisco* concerned the characterization of collective bargaining agreements as executory contracts and the combined

effect of national labor policy and the Bankruptcy Code. It did not address the question raised here concerning the *effect* of a determination that a contract is executory on the DIP's pre-petition performance of the contract. Nowhere in *Bildisco* was it suggested that employees must return to the bankrupt employer wages which they received prior to Bildisco's filing. Neither *Bildisco* nor any other decision of this Court has considered whether § 365(g) of the Code authorizes the bankruptcy court to order rescission of a contract divesting the non-debtor of the right to use property it had acquired under the contract prior to the bankruptcy filing.

In urging the Court to deny Lubrizol's petition, Respondent explicitly concedes that licensors and licensees will have to change the way they do business with one another if the decision below is permitted to stand. Br. in Opp. at 4-5. Respondent proposes that to avoid the new risks created by the decision below, inventors of new technology "will have to sell technological advancements to developers" of that technology. *Id.* This "solution" demonstrates the dilemma that the decision below creates for those seeking funding of new technological development. A party without sufficient funds to finance the full development of his idea would be forced either to abandon the development or to give up any continuing rights to his technology. In effect, the decision makes it impossible for the weaker party to license—he can only sell the fruits of his labor thus terminating any further or continuing interest in it. Ironically, Respondent argues for precisely the solution which was least acceptable to RMF when it was operating.

Trade secret law, which Congress and this Court have wisely chosen not to disturb, and which the court below ignored, exists to avoid this dilemma.

> Trade secret law promotes the sharing of knowledge, and the efficient operation of industry; it permits the

> individual inventor to reap the rewards of his labor by contracting with a company large enough to develop and exploit it. Congress, by its silence over these many years, has seen the wisdom of allowing the States to enforce trade secret protection.

*Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. at 493. Congress surely did not intend that the bankruptcy laws should reverse this view and create disincentives for technology development and sharing.

### IV. The Decision Below Has and Will Mislead Bankruptcy Courts By Masking the Subtle Issues Relating To Intellectual Property.

The unquestioning acceptance of the Fourth Circuit's misconstruction of § 365 which is apt to occur in many bankruptcy courts is exemplified by the recent decision in *In re Chipwich, Inc.*, 54 Bankr. 427 (Bankr. S.D.N.Y. 1985). In *Chipwich* the court quoted at length from the opinion below and held that the licensee of a trademark is deprived of all rights to that trademark when the licensor rejects the license under § 365. 54 Bankr. at 431. While the *Chipwich* bankruptcy court's conclusion may or may not be correct, it is clear that that court, following the lead of the Fourth Circuit, did not engage in the necessary analyses of (1) the subtle but crucial distinctions between various kinds of intellectual property, (2) the effect under applicable non-bankruptcy law of a breach of the contract involved, or (3) the full effect of contract rejection under § 365.

Clear distinctions exist between intellectual property protected under patent, copyright, or trademark law and that protected under trade secret law particularly in the area of disclosure. *See generally*, Nimmer, The Law of Computer Technology (1985). For instance, patent law requires disclosure. 35 U.S.C. § 112 (1982). In contrast, "[i]f an individual discloses his trade secret to others who

are under no obligation to protect the confidentiality of the information, or otherwise publicly discloses the secret, his property right is extinguished." *Ruckelshaus v. Monsanto Co.*, 104 S. Ct. at 2873.

The court below purported to adopt the definition of "executory contract" set forth in Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 Minn. L. Rev. 439, 460 (1973). Pet. App. at 3a; 756 F.2d at 1045. Explicit in that definition is the conclusion that the DIP's rejection excuses the non-debtor's performance of the rejected contract. Thus, the ultimate irony of the position taken by RMF in these proceedings is that, under a correct analysis of the law of trade secrets, rejection relieves Lubrizol of its duty to maintain confidentiality and destroys the very proprietary right which RMF would seek to market elsewhere for new consideration.

The court below has construed § 365 without evidencing an understanding of these distinctions, and the *Chipwich* court adopted that construction again without any analysis of the nature of the property interests being affected. Until the decision below is corrected, its erroneous construction of § 365 will limit the options available to parties entering into new contracts and will cause the loss of property of parties whose only fault was doing business with "potential bankrupts." Further, it may cause DIPs to take action—contract rejection releasing the non-debtor of its obligation to maintain the confidentiality of trade secrets—which destroy the very property interest which they seek to exploit.

## CONCLUSION

The decision below is the result of a significant misunderstanding about the meaning of contract rejection in bankruptcy. This Court should promptly make it clear that contract rejection under § 365(a) is nothing more than a material breach of the contract. The consequences which flow from that breach in bankruptcy are only different from those which accompany a contract breach outside bankruptcy in the limitation of remedies available to the non-breaching party. Nothing in the Code creates remedies in favor of the breaching party.

For the reasons stated, a writ of certiorari should be granted.

Respectfully submitted,

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**On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit**

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## BRIEF AMICI CURIAE ELECTRONIC INDUSTRIES ASSOCIATION NATIONAL ELECTRICAL MANUFACTURERS ASSOCIATION IN SUPPORT OF PETITIONERS

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## BRIEF AMICI CURIAE ELECTRONIC INDUSTRIES ASSOCIATION NATIONAL ELECTRICAL MANUFACTURERS ASSOCIATION IN SUPPORT OF PETITIONERS

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### INTEREST OF AMICI CURIAE

With more than 1000 participating companies, the Electronic Industries Association (EIA) is the full-service national trade organization representing the spectrum of United States companies manufacturing electronic products. With more than 500 participating companies, the National Electrical Manufacturers Association (NEMA) represents the electrical manufacturing industry, including generation, transmission, distribution, control and end-uses of electricity. The industries repre-

sented by these associations have a total employee population of over 1.8 million and shipped more than $172 billion of product in 1984. According to the National Science Foundation, the electrical and electronic industries (Standard Industrial Code 36) spent $8.5 billion on research and development in 1983, the latest year for which figures are available.

Engaged in technology-intensive industries, our member companies are heavily dependent on technology licensing—as a source of revenue and as a means to obtain needed rights and know-how to manufacture competitive products. The Fourth Circuit's decision severely undercuts technology licensing and, thus, we respectfully file this brief in support of petitioner's request for Supreme Court review of that decision.

## STATEMENT OF THE CASE

Petitioner Lubrizol Enterprises, Inc. (LEI), and Richmond Metal Finishers, Inc. (RMF), entered into a Technology License Agreement dated July 8, 1982, (the "Agreement"). Pursuant to the Agreement, RMF disclosed to LEI certain technical information then owned by RMF. The Agreement gave LEI the nonexclusive right to use, make, have made and sell products using and embodying the technology. In return, LEI agreed to maintain the confidentiality of the technology for a 17-year period and to pay royalties to RMF during the 17-year period.

In July 1983, RMF filed a Petition for Relief under Chapter 11 of the Bankruptcy Reform Act of 1978 (the "Code"). At this time, LEI had not, as yet, used the technology to make its first commercial sale. RMF then moved for authorization from the Bankruptcy Court to reject the license agreement under Section 365(a) of the Code, 11 U.S.C. 365(a). At the hearing on the Motion, RMF's President testified that RMF sought re-

jection of the agreement in order to grant an exclusive license of the technology to a third party. No other reason was given to support the Motion. Over LEI's objection, RMF's Motion was granted.

LEI appealed to the District Court, for the Eastern District of Virginia (District Court), which found that RMF's stated reason for rejecting the agreement was based on a misperception of the law. The District Court found that RMF could not use Section 365 to deprive LEI of technology that had been disclosed and transferred prior to RMF's bankruptcy filing. RMF then appealed this decision to the United States Court of Appeals for the Fourth Circuit.

Although taking note of the chilling effect its decision might have upon the willingness of such parties to contract, the Court of Appeals reversed the District Court. A petition for rehearing was denied by the Court below.

## ARGUMENT

American industry has flourished upon the cross fertilization of innovation which occurs via the licensing and cross-licensing of technology.

A company will normally acquire a technology license —whether of trade secrets or of patent rights—to supplement its present knowledge and rights in order to manufacture and sell a product successfully. A company's willingness to acquire a license must rest upon satisfactory assurance that the transfer of such knowledge, rights, or both, cannot later be abrogated. The reason for this is that the licensee normally makes significant additional investments in development, capital equipment and personnel to manufacture and market the end product. These subsequent investments often dwarf the licensee's initial investment in the license.

If allowed to stand, the Court of Appeals' decision will put at risk a licensee company's entire investment, making it dependent on the continued business viability of the licensor. The larger the size of the licensee's total investment in the products and the greater the commercial success of such products, the greater the likelihood that in the event of the licensor's bankruptcy, Section 365 of the Code may be used to rescind the license in order that the bankrupt estate may negotiate a better deal.

Potential licensees will hesitate to acquire rights in the face of such uncertainty. They will be most hesitant to acquire a license from the companies to whom licensing revenue might be pivotal—fledgling risk capital companies without large-scale financial backing. For these reasons they will be hesitant to enter into cross-license arguments with such companies. Such companies often are at the leading edge of technological change, but they typically lack superior credit ratings. They are often thinly capitalized and lack sufficient immediate cash flow—a primary cause of bankruptcy.

The issues in this case go far beyond the immediate rights and interests of the parties. Technology licensing is central to the health and growth of industry. Permitted to stand, the decision of the court below will significantly decrease the commercial utilization of new technology to the detriment of American industry and the American public.

## CONCLUSION

We respectfully request the Court to grant certiorari in this case and to hold that once technology has been disclosed and rights thereto transferred to a licensee, neither general principles of contract and property law nor the Bankruptcy Code permit its recapture.

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**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit**

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## BRIEF AMICUS CURIAE FOR COMPUTER AND BUSINESS EQUIPMENT MANUFACTURERS ASSOCIATION (CBEMA) IN SUPPORT OF THE PETITIONER

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**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit**

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## BRIEF AMICUS CURIAE FOR COMPUTER AND BUSINESS EQUIPMENT MANUFACTURERS ASSOCIATION (CBEMA) IN SUPPORT OF THE PETITIONER

---

Computer and Business Equipment Manufacturers Association ("CBEMA") submits this brief as amicus curiae in support of Lubrizol Enterprises, Inc.'s ("Lubrizol") Petition for A Writ of Certiorari to the United States Court of Appeals For the Fourth Circuit filed on November 19, 1985. Pursuant to Rule 36.1 of the Rules of the Supreme Court of the United States, this brief is

submitted with the written consent of the parties filed simultaneously with the Clerk.

## INTEREST OF THE AMICUS CURIAE

CBEMA, formerly known as the Business Equipment Manufacturers Association, is the trade association which has represented the computer and business equipment industry since 1916. The companies comprising the current CBEMA membership include the nation's leading manufacturers of computers, telecommunications and business equipment and related supplies and services. CBEMA is the leading spokesman for the computer and business equipment industry, representing some 34 companies,[1] both large and small, having an estimated combined sales of over $135 billion. Member companies of the association include both hardware and software manufacturers and provide over 1.2 million job opportunities throughout the United States. While product lines of member companies vary widely, the following list is illustrative: electronic computers, computer software including programs, computer input and output devices, computer storage devices, support services, telecommunications equipment, optical character readers, addressing machines, accounting machines, bookkeeping machines, office

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[1] The following companies are members of CBEMA; 3M; Amdahl Corporation; AMP Incorporated; Apple Computer, Inc.; AT&T; Bell & Howell; Burroughs Corporation; Control Data Corporation; Dictaphone Corporation; Digital Equipment Corporation; Eastman Kodak Company; GF Furniture Systems, Inc.; Harris/Lanier; Hewlett-Packard Company; Honeywell Information Systems, Inc.; IBM Corporation; ICL, Incorporated; Information Handling Services; Micro Switch, a Honeywell Division; AM International, Inc.; NCR Corporation; Panasonic Industrial Company; Philips Business Systems, Inc.; Prime Computer, Inc.; Royal Business Machines, Inc.; Sanders Associates, Inc.; SMA Corporation; Sony Corporation of America; Tektronix, Inc.; Terminal Data Corporation; Texas Instruments Incorporated; UARCO Incorporated; Visual Technology Corporation; and Xerox Corporation.

copying machines, and supplies and services for these products.

CBEMA companies have consistently been forerunners in developing information processing technology. In addition, they have contributed greatly to the present significant status and role of information processing in modern society and the international competitiveness of the United States in this industry. The extent to which such products and services can be utilized effectively depends in great measure on the ability of CBEMA companies to engage in licensing transactions, either as licensor or licensee, for the use of new technology and know-how.

These member companies are continuously involved in licensing transactions, either as licensor or licensee, for the transfer of intellectual property related to the hardware and software products which they manufacture, use or market. Licensing is particularly crucial in the software segment of the industry since in today's marketplace, software is usually copyrighted so that transactions are accomplished most frequently by licenses rather than by sales. Whether the user is an individual or an organization, the transfer of computer software is accomplished not by direct sale but pursuant to a license to use.

Licensing transactions may take many forms. They may be transactions which provide needed financing to small innovative enterprises. They may involve multi-tiered licenses of technology with a number of entities. Whatever the form, licensing is one of the principal methods of technology transfer throughout the world. Licensing, therefore, must remain a predictable and safe business transaction.

The subject matter of the present case is one of great significance for the CBEMA membership. These companies are vitally concerned with the protection of licensing agreements, since licensing is a central business practice of the industry. The Fourth Circuit's decision adversely

impacts upon both the immediate and the future planning of CBEMA companies with respect to the ways and means of transferring intellectual property. The transfer of intellectual property is necessary for promoting the use of information processing products, for research and development and for many other aspects of the information processing industry. The Fourth Circuit's decision inevitably affects the future growth and development of the information processing industry in the United States, and has even a greater impact on the vast segments of our society which use and receive the benefits of this technology.

## STATEMENT OF THE CASE

The facts and proceedings below are fully set forth in the Petition For A Writ Of Certiorari To The United States Court of Appeals For The Fourth Circuit filed by Petitioner Lubrizol Enterprises, Inc., on November 19, 1985.

## SUMMARY OF ARGUMENT

The question of whether § 365 of the Bankruptcy Code, 11 U.S.C. § 365,[2] authorizes the bankruptcy court, on request of the debtor, to rescind all contractual obligations divesting the nondebtor of property it had already acquired under the contract prior to the bankruptcy filing is one which the Supreme Court should resolve now.

The language of § 365 and equitable principles normally relied upon in bankruptcy point powerfully in one direction. The holding below points in the other. Everyday contractual relationships are now in jeopardy because, under the Fourth Circuit's erroneous interpretation of § 365, each party fears that the other party will file for bankruptcy and seek complete recission of the performance rendered prior to the bankruptcy.

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[2] The statute at issue here, Bankruptcy Reform Act of 1978, § 365, 11 U.S.C. § 365 (1982), is reprinted in the Appendix to the Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit filed November 19, 1985 at 43a-49a ("Petition for Certiorari"). The statute will be referred to as § 365.

The Fourth Circuit has erred (1) by deciding that contracts are "executory" based solely on continuing, but insignificant and unburdensome, obligations between the parties and (2) by subjecting the nondebtor, who in this case is the licensee, to arbitrary and unfair results without taking into account equitable considerations.

This Court should eliminate the error caused by the Fourth Circuit's decision and restore the predictability so needed to maintain viable contractual relationships in today's business climate.

## ARGUMENT

### REASONS FOR GRANTING THE WRIT

#### I. This Court Should Grant The Writ To Prevent The Fourth Circuit's Decision From Adversely Affecting The Entire Structure Of The Information Processing Industry, Its Manner Of Doing Business, Its Users And The Public At Large

This case is not merely an isolated dispute between two parties. It has broad-scale implications for the entire information processing industry. If the Fourth Circuit's decision is permitted to stand unreviewed, licensing contracts are now a risky, unpredictable and undesireable means of transferring new technology and know-how in the computer industry. Licensing has been an indispensable part of everyday business for CBEMA's membership, for the information processing industry and for information processing users as a whole. The latter comprise virtually the entire business base of the industrial world.

As it stands now, the Fourth Circuit has held that, if a court finds a contract to be "executory," the licensor [3]

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[3] This brief deals with a dispute involving a technology licensor's bankruptcy proceeding. All references, therefore, to licensor refer to the debtor, and all references to licensee refer to the non-debtor.

having filed for bankruptcy has unfettered and unquestioned ability to cancel all obligations under the contract, and even to recoup transfers of property made prior to the filing of the petition for bankruptcy. This decision leaves the licensee helpless to protect its rights to property transferred prior to the licensor's bankruptcy petition.[4]

Without review by this Court, many adverse ramifications affecting this industry will flow from the Fourth Circuit's decision. Among the most apparent are:

- Investment in and plans for the development of innovative technology will be stunted and may never come to fruition. Without a licensee's marketing and development, new ideas may never surface in the marketplace or be exploited for the benefit of the industry or the public.
- The benefits of much technological innovation will be lost and an industry, whose existence depends on fast-developing technology, will be injured.
- Companies may seek to circumvent the "executory" nature of a licensing contract and enter only those contracts that cannot be found by the courts to be "executory." For example, a licensee may be forced to make all royalty payments at the commencement of the contract. For many companies, such payments would be too costly and will inhibit their desire to license the technology.
- The cost of doing business will increase in order for licensees to cover the enormous risks of licensing technology in good faith and later losing all rights to such technology pursuant to § 365.

The Fourth Circuit's decision, as it stands, will influence far more than a dispute between Lubrizol and the

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[4] The Fourth Circuit decision, reported at 756 F.2d 1043 (4th Cir. 1985), is reprinted in the Appendix to the Petition for Certiorari at 1a-10a.

bankrupt; it will exert an adverse impact on the everyday business transactions of the entire information processing industry.

## II. This Court Should Grant The Writ To Prevent The Arbitrary And Inequitable Deprivation Of The Licensee's Rights

### A. *This Court Should Grant The Writ To Protect A Licensee's Reasonable Expectation That Completed Performance Under A Contract Cannot Be Undone*

The Fourth Circuit's decision, as it stands, will cause drastic consequences for the licensee relying on its agreement with the licensor to make use of certain software technology. For example, a licensee may have obtained the use of a licensor's software for the purpose of developing and maintaining a much needed bookkeeping system for its business. The licensing agreement may provide that the licensor must update the bookkeeping software on a periodic basis while the licensee must make ongoing payments. The licensor may file for bankruptcy many years later. Based on the Fourth Circuit's erroneous interpretation of § 365, the licensor will succeed in its bid to convince the bankruptcy court that the licensing agreement constitutes an executory contract. Under the Fourth Circuit's decision, the licensor is relieved of all past and future obligations under the licensing agreement. The licensee, therefore, will lose its right to use the bookkeeping software on which its business now depends. This result, by itself, could force a licensee into dire straits.

Another situation exemplifies the gross inequities resulting from the Fourth Circuit's decision. A licensor may own a patent on a unique manufacturing process which it agrees that the licensee may use. The licensing agreement may provide that the licensor is obligated to sue any companies infringing on the patent and that the licensee is obligated to make ongoing payments. In order to accommodate the unique process, the licensee may be forced to make massive capital expenditures. The licensor

subsequently may file for bankruptcy and, pursuant to § 365, convince the bankruptcy court to reject all its obligations under the licensing agreement because the licensor's promise to sue the infringers made the agreement "executory" in nature. Under the Fourth Circuit's decision, the licensee would lose not only its right to make use of the manufacturing process but also the capital expenditures that the licensee made in reliance on the agreement. The ripple effects of such a loss on the licensee's business could force the licensee into bankruptcy or, at best, into severe economic hardship.

This Court should grant the writ in order to review two premises underlying the Fourth Circuit's decision which lead to such inequitable results: first, whether any or all licenses are properly viewed as *per se* executory; and second, whether courts may continue to rely on equitable considerations to prevent an arbitrary and inequitable deprivation of the licensee's rights when considering whether to assume or reject contractual obligations under § 365.

### B. *This Court Should Grant The Writ To Protect Against The Arbitrary Characterization Of All Licensing Agreements As Executory Contracts*

Most future obligations in technology licensing agreements are insignificant compared to the accomplished transfer of intellectual property, and in fact are *de minimis* in nature. They place no real affirmative burdens on the parties and should not trigger the drastic results that, based on the Fourth Circuit's decision, flow from the designation of "executory" contract.

The Fourth Circuit's decision depriving the licensee of the property it acquired from the debtor prior to the latter's filing for bankruptcy turned entirely upon a characterization of the contract as "executory" under § 365. Even where any future obligations under the agreement are merely insignificant and contingent, the debtor under the Fourth Circuit's decision is given an automatic right to rescind all contractual obligations performed before it filed for bankruptcy.

Congress did not expressly define the term "executory contract" as used in the Bankruptcy Code. No statutory definition, therefore, can be mechanically applied for the purpose of rejecting the contract. *See In re Petur U.S.A. Instrument Co.*, 35 Bankr. 561, 563 (Bankr. W.D. Wash. 1983) ("The Code does not define the term 'executory contract' "). Rather, the analysis of whether a contract is executory is judicially-fashioned and should not result in arbitrary and inequitable decisions.[5] As the court recognized in *In re Gladding Corp.*, 22 Bankr. 632, 635 Bankr. D. Mass. 1982):

> It seems clear, at least to this court, that bankruptcy courts should not be bound by static definitions of what is an executory contract, but should strive to satisfy the purposes of the Act in conjunction with the goals of the debtor (or trustee), in order that equity may be served.

Because the term "executory contract" is not defined in the statute, courts, including the Fourth Circuit in this case, have looked to Professor Countryman's article on the matter. A careful reading of the entire Countryman article, however, reveals that Professor Countryman did not view licenses as *per se* executory contracts. Countryman, *Executory Contracts in Bankruptcy: Part II*, 58 Minn. L. Rev. 479, 502 (1974) ("Where there is no express undertaking by the licensor [to supply goods or services], the agreement with the licensee may not be executory because the licensor may have full performed merely by executing the license agreement").

The Fourth Circuit's decision, in contrast, assumes that all licenses are fundamentally executory. If the Fourth Circuit's decision is not reviewed by this Court, debtors will acquire a *new* right to rescind all past contractual

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[5] This Court in an entirely different context recognized that whether or not a contract is executory depends on the facts of each individual case. *N.L.R.B. v. Bildisco & Bildisco*, 104 S.Ct. 1188 (1984).

obligations merely because the contract is deemed to be executory.

The conclusion that a contract is executory is based upon the premise that a negative covenant—a promise *not* to take an action—is just as executory as an affirmative covenant. This conclusion, however, is at odds with the history of the treatment of contracts in bankruptcy. The concept underlying § 365 grows out of the well-placed desire to relieve a bankruptcy trustee or debtor-in-possession of ongoing burdensome obligations. *See* Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 Minn. L. Rev. 439, 440-47 (1973). To equate negative covenants —which generate no burden for the obligor—with affirmative covenants in applying § 365 rejection rights, however, results in an unjust enrichment of the bankruptcy estate for which there is no evidence of congressional intent.

Once the Fourth Circuit mechanically decided that the licensing agreement was "executory," Lubrizol as the licensee was guaranted to lose. This Court should grant review of this matter to examine the Fourth Circuit's assumption that all licensing agreements are necessarily executory contracts and to prevent the destabilizing consequences for business transactions that flow from that characterization.

### C. *This Court Should Grant The Writ To Ensure That Equitable Considerations Are Not Eliminated From A Vital Part Of The Bankruptcy Process*

Relying on a static definition of executory contract, the Fourth Circuit applied an arbitrary and mechanized approach to licensing contracts under § 365.[6] Having de-

[6] The requirement of § 365(a) that the trustee's assumption or rejection of an executory contract be "subject to the court's approval" dictates a non-mechanical approach to issues involved in executory contracts. The court must be active in determining what is, and is not, an executory contract and in disposing fairly of those arrangements found to be executory in nature.

cided that the contract was executory, the Fourth Circuit deferred totally to the licensor's decision that it would be advantageous to terminate all rights granted under the agreement. Based on the business judgment rule, the court created an insurmountable burden for the licensee by defining the issue as "whether the decision of the debtor [licensor] that rejection will be advantageous is so manifestly unreasonable that it could not be based on scund business judgment, but only on bad faith, or whim or caprice." [7] The court underscored the difficulty faced by the licensee seeking to protect its interests by stating that this determination is "reviewable up the line under the clearly erroneous standard." [8]

The Fourth Circuit's decision has made it virtually impossible for a licensee to protect its rights in property, in this case technological know-how, transferred by the licensor prior to its bankruptcy. As if to underscore the licensor's complete discretion to eradicate all pre-petition obligations under the licensing agreement, the court held that "equitable considerations" had no place in the court's decision.[9] Rather, the Fourth Circuit stated that licensees "share the general hazards created by § 365 for all business entities dealing with potential bankrupts. . . ." [10]

In direct contrast with this approach is *In re Petur U.S.A. Instrument Co.*, 35 Bankr. 561 (Bankr. W.D. Wash. 1983), where the court balanced the equities of both parties in denying the debtor's motion to reject an executory contract. Despite its agreement with the debtor that the contract was executory and that rejection of the contract would be in its best interests, the court engaged in an independent evaluation of the effect of rejection on

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[7] Petition for Certiorari, Appendix at 7a.

[8] *Id.*

[9] *Id.* at 9a.

[10] *Id.* at 10a.

both parties. In doing so, the court refused merely to rubber-stamp the business judgment of the debtor. The court's major concern was that if it upheld the rejection of the contract, the non-debtor would be forced out of business. 35 Bankr. at 563. The court stated:

> Counsel for the debtor has cited a number of cases involving rejection in which harm has resulted to the non-debtor parties. . . . But here we are not only dealing with harm resulting from a mere disappointment of legitimate expectations. Rather we are dealing with the actual ruination of an otherwise profitable, successful and ongoing business. Equity will not permit such a result.

35 Bankr. at 564 (citations omitted). Looking to equity for assistance, the court properly weighed the business judgment of the debtor against the adverse effects of rejecting the contract on the non-debtor. As the court stated in *In re Petur U.S.A. Instrument Co.*, "[i]t is well-established that bankruptcy proceedings are equitable in their nature." 35 Bankr. at 563.

The Fourth Circuit refused to consider the inequitable effects of its decision on the licensee. This Court should grant review in this case to ensure that equitable considerations remain a viable part of the decision as to whether to assume or reject contractual obligations under § 365.

## CONCLUSION

CBEMA respectfully requests that the petition of Lubrizol Enterprises, Inc. be granted (1) to prevent the arbitrary and inequitable deprivation of a licensee's rights to property transferred prior to the debtor's filing for bankruptcy, and (2) to correct an erroneous interpretation of § 365 that will disrupt substantially the predictability of commercial transactions, especially in the information processing industry. The Fourth Circuit's decision should be reviewed and reversed to prevent major un-

certainty and serious inequity from arising out of good faith business transactions.

Respectfully submitted,

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# In the Supreme Court of the United States

October Term, 1985

LUBRIZOL ENTERPRISES, INC.,
*Petitioner,*

v.

RICHMOND METAL FINISHERS, INC.,
*Respondent.*
IN RE: RICHMOND METAL FINISHERS, INC.,
*Debtor.*

## AMICUS BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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**IN THE SUPREME COURT OF THE UNITED STATES**

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No.

LUBRIZOL ENTERPRISES, INC.,
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In Re: RICHMOND METAL FINISHERS, INC.,
*Debtor.*

# AMICUS BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

## Interest of Amicus Curiae

Licensing Executives Society ("LES") is a nonprofit professional and educational organization comprised of members actively involved in the transfer of technology and intellectual property rights (patents, trademarks, copyrights and know-how, including trade secrets). It is a business-oriented society of over 2,000 members from industry, law firms, universities, research institutes and various Government organizations. LES has sister societies in many other countries throughout the world. It has been estimated that LES members are involved in over 85% of worldwide technology transfer.

The agreement between Lubrizol and Richmond Metal Finishers, Inc. at issue in this case is an arrangement involving the transfer of unpatented, confidential technology. One

of the principal methods by which technology is transferred is in the form of licenses of unpatented technology. Empirical research suggests that the value of such trade secret or know-how licensing is greater even than that of patent licensing. *See* Bleeke & Rahl, The Value of Territorial and Field-of-Use Restrictions in the International Licensing of Unpatented Know-how: An Empirical Study, 1 Nw. J. Int'l L. & Bus. 450, 455–58 (1979). Indeed, the Report of the President's Commission on Industrial Competitiveness cited the development and commercialization of technology as keystones to our nation's ability to meet its competitive challenges. *See* The Report of the President's Commission on Industrial Competitiveness, "Global Competition, The New Reality," pp. 1–2, 45–46, 51–52 (1985).

Accordingly, the issue presented in this case is a matter of great importance to LES and industry generally. Briefly stated, the question is whether Section 365 of the Bankruptcy Code authorizes the court to rescind a license contract transferring rights in confidential, unpatented technology and order restitution of benefits that were conferred upon the licensee prior to the bankruptcy filing. LES wishes to inform the Court that it should grant certiorari in this case because the decision below conflicts with the law and strong policy favoring preservation of previously transferred, unpatented technology rights, even in the face of filing for bankruptcy by the licensor.

## ARGUMENT

The decision below conflicts with recent Supreme Court decisions that have emphasized the importance and integrity of technology licenses, *see Aronson* v. *Quick Point Pencil Co.*, 440 U.S. 257 (1979); *Kewanee Oil Co.* v. *Bicron Corp.*, 416 U.S. 470 (1974), and is also contrary to the decisions of other federal

courts of appeal construing the Bankruptcy Code which do not premit rescission of pre-petition performance by the debtor, *see generally* Petitioner's Brief in Support of Writ of Certiorari.

In *Kewanee Oil Co.* v. *Bicron Corp.*, 416 U.S. 470 (1974), this Court looked closely at the policy underlying the protection of confidential unpatented technology and contracts respecting such technology. This Court held that the patent law did not preempt state trade secret law in light of that policy.

According to the Court:

> "The maintenance of standards of commercial ethics and the encouragement of invention are the broadly stated policies behind trade secret law. 'The necessity of good faith and honest, fair dealing, is the very life and spirit of the commercial world.'" *Id.* at 481-82.

The Court recognized that:

> "Trade secret law will encourage invention in areas where patent law does not reach, and will prompt the independent innovator to proceed with the discovery and exploitation of his invention. Competition is fostered and the public is not deprived of the use of valuable, if not quite patentable, invention." *Id.* at 485.

The necessity of licensing as a means for the desired "exploitation" was stressed in the *Kewanee* decision. This Court recognized the importance "of licensing others to use [the] invention and making the most efficient use of existing manufacturing and marketing structures within the industry, . . ." *Id.* at 486. The Court explained that denial of trade secret protection and related contracts would "tend . . . to limit . . . utilization of the invention, thereby depriving the public of the maximum benefit of its use, . . ." *Id.* at 486.

In sum:

> "Trade secret law promotes the sharing of knowledge, and the efficient operation of industry; it permits the individual inventor to reap the rewards of his labor by contracting with a company large enough to develop and exploit it." *Id.* at 493.

Similarly, in *Aronson* v. *Quick Point Pencil Co.*, 440 U.S. 257 (1979), this Court ruled in favor of preserving the sanctity of the unpatented technology contract. The Court relied upon its decision in *Kewanee* and held that a license of unpatented technology requiring royalties so long as the technology was used was enforceable, notwithstanding that the licensed technology had entered the public domain and a patent application on the technology had been rejected. Again, this Court stressed the importance of enforcing the licenses of unpatented technology to

> "encourage invention . . . [and] prompt the independent innovator to proceed with the discovery and exploitation of his invention." *Id.* at 266.

These recent Supreme Court precedents recognize the critical function not only of the inventor (*i.e.*, the licensor), but also of the investor in the technology (*i.e.*, the licensee). As the Court of Appeals stated with respect to analogous patented technology in *SCM Corp* v. *Xerox Corp.*, 645 F.2d 1195, 1206 n.9 (2d Cir. 1981), *cert. denied*, 455 U.S. 1015 (1982):

> "Investors . . . play a key role, if not an indispensable one today, in both the inventive process and commercialization of inventions. And it is fair to say, we think, that the contribution of the investor in both the funding of research that leads to inventions and the promotion that necessarily must follow to achieve successful commercialization is of comparable value.

*See also Picard* v. *United Aircraft Corp.*, 128 F.2d 632, 641 (2d Cir.), *cert. denied*, 317 U.S. 651, 63 S.Ct. 46, 87 L.Ed. 524 (1942) (Frank, J. concurring).

The reason for the public policy in favor of protecting the licensee is plain. The process of innovation is a long, expensive and risky one. The inventive concept is the first of an expensive series of steps continuing through research, applied research, development, manufacturing and marketing. The licensee, in many cases, performs and finances the steps following generation of the basic idea. The expense is often modest at the invention stage, but it increases as a product is developed, tooled for manufacturing and, finally, marketed. The success rate for new products, let alone inventive concepts, is small. As the President's Commission on Industrial Competitiveness concluded: "Research and development are always risky. If the developers of a new technology cannot be assured of gaining adequate financial benefits from its commercialization, they have few incentives to make the huge investments required." The Report of the President's Commission on Industrial Competitiveness, "Global Competition, The New Reality," p. 21 (1985). For these reasons, the law seeks to protect the license in order to foster the functions performed by the licensee in the innovation process.

The Fourth Circuit's decision will jeopardize the innovation process, contrary to the prevailing public policy. Lubrizol, before Richmond's bankruptcy filing, received a transfer of unpatented technology with perpetual rights, subject to certain payment obligations. If a pre-bankruptcy filing transfer of license rights can be rescinded by the debtor-in-possession and the debtor can obtain restitution of benefits already conferred, it would jeopardize the investment in, and plans for, development and exploitation by the licensee. Without the licensee's development efforts, in many instances an idea will not be exploited at all; in others, utilization of the idea will not be maximized. If the licensor's bankruptcy can abruptly terminate the licensee's rights and nullify his investment and plans, the licensee — and the public — will suffer the sudden loss of the benefits of the innovation. By the same token, such

a disruptive result must make licensees wary of dealing with financially weak licensors. While the licensee is left with a claim for damages against the insolvent debtor-in-possession, society will not be compensated for the lost or sidetracked innovation. Progress, competition and economic benefit to the public will be the losers.

## CONCLUSION

For these reasons, as well as those set forth in the Petition for Writ of Certiorari of Lubrizol, LES requests that the Court grant the Petition for Writ of Certiorari.

December 20, 1985

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